Supreme Court, U.S.
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89-935

NO. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants

v.

VALERO TRANSMISSION COMPANY,
Appellee

On Appeal From The Court of Appeals For The Fourth Supreme Judicial District of Texas

JURISDICTIONAL STATEMENT

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December 7, 1989

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QUESTIONS PRESENTED

1. Whether the Railroad Commission of Texas Gas Market Demand Rule as applied by a Texas Court of Appeals voiding take-or-pay obligations and liability in a natural gas purchase contract is preempted by the Natural Gas Policy Act.

2. Whether the Railroad Commission of Texas Gas Market Demand Rule as applied by a Texas Court of Appeals voiding take-or-pay obligations and liability in a natural gas purchase contract violates the Commerce Clause of the United States Constitution.

COMPLETE LIST OF PARTIES

Appellants: Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley, Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H. B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters, and Theodore L. Wilkinson.

Appellee: Valero Transmission Company.

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Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley, Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H. B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters, and Theodore L. Wilkinson (collectively referred to as "Appellants") appeal from the final judgment of the

Court of Appeals for the Fourth Supreme Judicial District of Texas, San Antonio, Texas ("Texas Court of Appeals") entered in this action on March 31, 1988, as modified on rehearing May 18, 1988, affirming the trial court and applying the Railroad Commission of Texas Gas Market Demand Rule so as to relieve Valero Transmission Company ("Appellee") of its take-or-pay obligations and liability under its contract with Appellants despite Appellants' argument that the Texas Court of Appeals' application of the Texas Gas Market Demand Rule violates the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432, and the Commerce Clause of the United States Constitution, U.S. CONST., art. I, § 8, cl. 3.

OPINIONS BELOW

The opinion of the Texas Court of Appeals of March 31, 1988, is in the Appendix hereto, p. 1. The opinion of the Texas Court of Appeals on rehearing of May 18, 1988, is reported at 751 S.W.2d 649 and is in the Appendix, p. 16.

JURISDICTION

The Supreme Court of Texas denied Appellants' application for writ of error on June 7, 1989. Appendix, p. 32. A motion for rehearing was filed and overruled on September 13, 1989. Appendix pp. 125, 34. The judgment of the Texas Court of Appeals is the judgment appealed from, since the Texas Supreme Court denied discretionary review. *Interstate Circuit, Inc. v. City of Dallas*, 390 U.S. 676, 678 n. 1 (1968).

A notice of appeal to this Court was timely filed in the Texas Court of Appeals and also filed with the Texas Supreme Court on September 22, 1989. Appendix, p. 38.

This appeal is being docketed in this Court within 90 days from the denial of rehearing by the Texas Supreme Court. The jurisdiction of the Court is invoked under 28 U.S.C. § 1257(2), which was *amended by* 28 U.S.C. § 1257 (1988). Appeal under the prior version of Section 1257 is proper because the judgment of the Texas Court of Appeals appealed from was entered prior to the September 25, 1988, effective date of the 1988 amendment, which abolished "appeal" bases for review by this Court.

CONSTITUTIONAL PROVISIONS, STATUTES, AND RULES

U.S. CONST., art. I, § 8, cl. 3:

> The Congress shall have the power . . . [t]o regulate Commerce . . . among the several States. . . .

U.S. CONST., art. VI:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Natural Gas Act of 1938, 15 U.S.C. §§ 717-717w ("NGA"). The full text of the NGA is at Appendix, p. 137.

Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 ("NGPA"). The full text of the NGPA is at Appendix, p. 169.

Railroad Commission of Texas Gas Market Demand Rule, 16 Tex. Admin. Code §§ 3.30 and 3.34. The full text of the Texas Gas Market Demand Rule is at Appendix, p. 286.

HOW THE FEDERAL QUESTION WAS RAISED

At the first opportunity, Appellants raised the claim that the Texas Gas Market Demand Rule as applied by the Texas Court of Appeals violates the NGPA and the Commerce Clause of the United States Constitution. Appellants' motion for rehearing before the Texas Court of Appeals argued that:

> The Court's action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid because the Texas Gas Market Demand Rule as applied by the Court is pre-empted by the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301 *et seq.*, and violates the Commerce Clause of the United States Constitution, U.S. Const. art. I, § 8, cl. 3.

Appendix, p. 57. Appellants' motion for rehearing in the Texas Court of Appeals raised the following points of error:

> 23. Point of Error: The Court's action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid because the Texas Gas Market Demand Rule as applied by the Court is pre-empted by the Natural Gas Policy Act.
>
> 24. Point of Error: The Court's action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid because the Texas Gas Market Demand Rule as applied by the Court violates the Commerce Clause of the United States Constitution.

Appendix, p. 57. Points of Error Nos. 23 and 24 were not raised prior to Appellants' motion for rehearing—which was denied by the Court of Appeals in a new opinion that did not address the Constitutional questions Appellants raised—because the error complained of was created by the opinion of the Texas Court of Appeals. The Texas Court of Appeals' opinion, and not any action of the trial court, was the basis for Points of Error Nos. 23 and 24.

This Court has consistently recognized that a federal question is timely and properly presented in a motion for rehearing to a state court when the basis for decision of that state court creates the federal question. *See, e.g., Herndon v. Georgia,* 295 U.S. 441, 443-44 (1935); *Great Northern Railway Co. v. Sunburst Oil & Refining Co.,* 287 U.S. 358, 367 (1932); *Brinkerhoff-Faris Trust & Savings Co. v. Hill,* 281 U.S. 673, 678 (1930); *Missouri ex rel v. Missouri Insurance Co. v. Gehner,* 281 U.S. 313, 320-21 (1930). In addition, Rule 131(e) of the Texas Rules of Appellate Procedure recognizes that a point of error may be raised for the first time in a motion for rehearing in the court of appeals when the error originates in the court of appeals. Rule 131(e) provides in pertinent part: "Whether the matter complained of originated in the trial court or in the court of appeals, it shall be assigned as error in the motion for rehearing in the court of appeals." Under Rule 131(e):

> [A] point in a motion for rehearing can also be grounded on error that originated in the court of appeals. . . .
>
> Obviously, these errors could not have been raised earlier, since they occur for the first time when the court of appeals renders its judgment. Thus, they are

> not waived merely because they are presented for the first time in a timely filed motion for rehearing.

31 J. Wicker, Civil Trial and Appellate Procedure § 779, at 552-53 (Texas Practice 1985).

The preemption and Commerce Clause issues were urged also in Points of Error Nos. 12 and 13 in Appellants' Application for Writ of Error to the Supreme Court of Texas. Points of Error Nos. 12 and 13 are as follows:

> POINT 12. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals is pre-empted by the Natural Gas Policy Act.
>
> [Germane to: Point of Error 23, Appellants' Motion for Rehearing.]
>
> POINT 13. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the court of appeals violates the Commerce Clause of the United States Constitution.
>
> [Germane to: Point of Error 24, Appellants' Motion for Rehearing.]

Petitioners' Application for Writ of Error, Appendix, pp. 77-8. Appellant reurged those same points of error in its motion for rehearing on the Texas Supreme Court's denial of Appellants' application for writ of error. Petitioners' Motion for Rehearing, Appendix, p. 129.

STATEMENT OF THE CASE

The contract in question was entered into in 1973 between Appellants and Lo-Vaca Gathering Company, Appellee's predecessor. It grants to Appellee the exclusive right and the obligation to purchase all of Appellants' gas from the Contract Area for a period of 20 years.

The contract provides that Appellee will, for each Contract Year, either (1) take delivery of and pay for the Daily Contract Quantity of natural gas or (2) pay for the Daily Contract Quantity of natural gas, whether taken or not. The Daily Contract Quantity is defined as a quantity of gas equal to 90% of Appellants' daily deliverability of gas averaged over the Contract Year. The quantity of gas to be purchased by Appellee each Contract Year is determined by multiplying the Daily Contract Quantity by the number of days during the Contract Year during which Appellee's performance was not excused by the contract.

Article V, ¶ 5.3, of the contract provides in pertinent part as follows:

> Subject to the other provisions hereof, Buyer agrees to purchase and pay for (*or*, if Buyer's performance hereunder is not excused by other provisions of this Agreement, *pay for, if available, whether taken or not*) during the days of each contract year of the term hereof *a Daily Contract Quantity of gas from Sellers' Lands and Leases in the Contract Area equal to ninety percent (90%) of Sellers' daily Deliverability of gas hereunder.* Upon request by Buyer or Seller, *Sellers' Deliverability shall be determined and established by Buyer by testing the actual ability of Sellers' wells to deliver into Buyer's facilities at the*

> *points of delivery;* provided, however, neither Seller nor Buyer shall request such Deliverability test more often than once in any ninety (90) day period. Such Deliverability tests shall be made after a stabilized rate of flow has been achieved against such pressure as is required to deliver into Buyer's facilities at the operating pressure at the points of delivery at the time of the test. . . .[1]

This provision in the contract is commonly known in the oil and gas industry as a "take-or-pay" clause.

The contract also contains a general definition of the term "deliverability" which differs from the specific use of that term in the take-or-pay provision quoted above. Article I(j) of the contract defines the term "deliverability" as:

> [T]hat quantity of gas which Seller has available for delivery from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction. Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects to take hereunder up to the maximum quantity which in accordance with good engineering and gas produc-

1. Emphasis added throughout except where indicated otherwise.

tion practice can be produced from Seller's wells in the fields.

Beginning with the 1982 Contract Year (June 1, 1982 - May 31, 1983), and continuing through the 1985 Contract Year, Appellee failed to either take and pay or simply pay for the minimum quantity of gas required by the contract.

Pursuant to Article VIII, ¶ 8.2, of the contract, Appellants calculated the amount due from Appellee under the take-or-pay provision to be $21,264,689.30.

Article VIII, ¶ 8.2, provides:

> If Buyer shall fail in any contract year of the term hereof to take the quantity of gas that Buyer is obligated to take hereunder, then Seller shall, within sixty (60) days after such contract year render a bill to Buyer based upon the weighted average price, including tax reimbursement, in effect hereunder during the contract year in which such deficiency occurred, computed on the volumes delivered during the year and at the price, including tax reimbursement, applicable to such volumes at the time of delivery thereof. If Buyer agrees with such statement, Buyer will make payment to Seller for the amount of such statement within sixty (60) days after receiving Seller's statement. In computing the amount due Seller for any deficiency in takes by Buyer occurring during any contract year, there shall be deducted from such deficiencies the following quantities:
>
> (a) The total of the quantities which Buyer requested, up to 111% of the Daily Contract Quantity, and which Seller failed to deliver for any reason on any day or days during such contract year; and

> (b) The total of the quantities of gas which Buyer was unable to take or failed to take on any day or days during such contract year by reason of force majeure; and
>
> (c) The total of the quantities of gas by which there was a deficiency in Seller's allowable for the wells covered hereby below the Daily Contract Quantity on any day or days during such year, excluding any portion of such deficiency which is caused by, or is a result of, Buyer's failure to nominate to the Texas Railroad Commission to purchase a quantity of gas equal to the Daily Contract Quantity; and
>
> (d) The total of the quantities of gas which Buyer refuses to take on any day or days during such year by reason of Seller's failure to meet any of the quality specifications or pressure requirements provided hereunder.

In asserting that it had no liability to Appellants under the take-or-pay provision of the contract, Appellee relied upon evidence that it took the amount of gas under the contract that it was authorized to take under the Texas Gas Market Demand Rule. The amount of gas Appellee took under its contract with Appellants was determined by Appellee's market demand for gas as reflected in its monthly nominations for gas filed by Appellee with the Texas Railroad Commission.

The trial court submitted Appellants' take-or-pay claim by way of two special issues to the jury. Special Issue No. 2 inquired whether "Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)." Special Issue No. 3, concerning the amount of money Appellee owed Appellants for its failure to take or pay for gas under the contract, was conditionally

submitted by the trial court upon an affirmative finding being made by the jury to Special Issue No. 2. Since the jury answered Special Issue No. 2 in the negative, it did not answer Special Issue No. 3. On the basis of the jury's answer to Special Issue No. 2, the trial court entered judgment against Appellants on their take-or-pay claim. Other special issues were submitted to the jury, and the part of the judgment incorporating the jury's findings on them was not appealed.

The Texas Court of Appeals, in affirming the trial court's judgment, held that the Texas Gas Market Demand Rule applies so as to relieve Appellee of its obligations under the "take-or-pay" provision of the natural gas contract. *Lively Exploration Co. v. Valero Transmission Co.*, 751 S.W.2d 649 (Tex. App.—San Antonio 1988, writ denied); Appendix, p. 16. The court based its opinion upon the provisions of the contract, including Article XIII, ¶ 13.1, making the agreement "subject to all valid applicable federal and state laws or city ordinances, and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction." 751 S.W.2d at 656; Appendix, p. 20.

I.

THE QUESTION IS SUBSTANTIAL

This case presents this Court with the substantial and novel question of whether the application of state ratable-take regulations to relieve pipeline purchasers of take-or-pay obligations and liability under natural gas contracts is preempted by the NGPA.

The Texas Court of Appeals premised its application of the Texas Gas Market Demand Rule on the above-

quoted government regulation clause, which is a standard provision in natural gas contracts. However, even if the contract did not include a government regulation clause, these laws and regulations would become a part of the contract and govern the transaction. *Wesseley Energy Corp. v. Jennings*, 736 S.W.2d 624 (Tex. 1987); *Langever v. Miller*, 124 Tex. 80, 76 S.W.2d 1025 (1934). Therefore, the effect of the Texas Court of Appeals' reliance upon the government regulation clause is to hold that the Texas Gas Market Demand Rule relieves *all* pipeline purchasers in Texas of their take-or-pay obligations under *all* of their natural gas contracts in the absence of an express provision to the contrary. The Texas Gas Market Demand Rule, as construed and applied by the Texas Court of Appeals, is preempted by the NGPA because it conflicts with the NGPA's goal of natural gas deregulation and reliance on market forces.

This case deserves the Court's attention "[b]ecause of the importance of the interstate market in natural gas." *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409, 411 (1986) ("*Transco*"). The Texas Court of Appeals' ruling is an unprecedented threat to natural gas price deregulation, because it invites the states to replace and second guess the purchasing decisions of the market. In *Transco*, 474 U.S. at 412, and *Northwest Central Pipeline Corp. v. State Corporation Commission of Kansas*, 489 U.S. ____, 103 L.Ed.2d 509, 522 (1989) ("*Northwest Central Pipeline*"), this Court recognized the crucial role take-or-pay clauses play in long-term natural gas contracts and encouragement of natural gas exploration and development. In light of the far-reaching adverse ramifications of the Texas Court of Appeals' decision on the NGPA's

goal of natural gas deregulation, this Court should note probable jurisdiction of this appeal.

Appellants' argument that the Texas Gas Market Demand Rule as applied by the Texas Court of Appeals is preempted by the NGPA rests on two considerations. First, the NGPA created a comprehensive scheme to govern future regulation of natural gas, and the Texas Gas Market Demand Rule as construed and applied by the Texas Court of Appeals falls "within the limits of that scheme, rather than within the category of regulatory questions reserved for the States." *Transco*, 474 U.S. at 420. Second, the Texas Gas Market Demand Rule as construed and applied by the Texas Court of Appeals "directly undermines Congress' determination that the supply, the demand, and the price of" interstate and intrastate natural gas "be determined by market forces." *Id.* at 422.

In 1963, this Court addressed the question of preemption under the Natural Gas Act of 1938, 15 U.S.C. §§ 717-717w, in the landmark case of *Northern Natural Gas Co. v. State Corporation Commission of Kansas*, 372 U.S. 84 (1962) ("*Northern Natural*"). The Court found Kansas' ratable-take orders were preempted, because they conflicted with the Federal Power Commission's authority under the NGA to regulate pipeline cost structure. The Court explained that:

> The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas. *Natural Gas Pipeline Co. v. Panoma Corp.*, 349 U.S. 44, 99 L ed 866, 75 S Ct 576, or for state regulations which would in-

> directly achieve the same result. These state orders necessarily deal with matters which directly affect the ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act. They therefore invalidly invade the federal agency's exclusive domain (footnote omitted).

Id. at 91-92.

In *Transco*, the Court was "confronted again with the issue of a state regulation requiring an interstate pipeline to purchase gas from all the parties owning interests in a common gas pool." 474 U.S. at 411. The starting point of the Court's analysis in *Transco* was *Northern Natural*, which "struck down, on preemption grounds, a virtually identical regulation." *Id.* The Court then revisited *Northern Natural* in view of the NGPA, which extended Federal Energy Regulatory Commission ("FERC") authority to the intrastate market and phased in price deregulation of natural gas. The Court explained *Northern Natural* as follows:

> *Northern Natural's* finding of pre-emption thus rests on two considerations. First, Congress had created a comprehensive regulatory scheme, and ratable-take orders fell within the limits of that scheme rather than within the category of regulatory questions reserved for the States. Second, in the absence of ratable-take requirements, purchasers would choose a different, and presumably less costly, purchasing pattern. By requiring pipelines to follow the more costly pattern, Kansas' order conflicted with the federal interest in protecting consumers by ensuring low prices.

Id. at 420. The Court then applied those two considerations to the Mississippi ratable-take order and found that order was preempted by the NGPA. *Id.* at 424-25. The Court held that Mississippi's ratable-take regulations were preempted because "Mississippi's action directly undermines Congress' determination that the supply, the demand, and the price of high-cost gas be determined by market forces." *Id.* at 422.

The Court rejected the appellees' argument that "Congress, in enacting the NGPA, altered those characteristics of the federal regulatory scheme which provided the basis in Northern Natural for a finding of pre-emption." *Id.* at 417. The Court found that "[t]he NGPA . . . does not constitute a federal retreat from a comprehensive gas policy." *Id.* at 421. Deregulation was a congressional decision that market forces, and not federal or state regulation, should determine the demand and price for, and the conditions of sale and purchase of, natural gas. As stated by the Court in *Transco*:

> To the extent that Congress denied FERC the power to regulate affirmatively particular aspects of the first sale of gas, it did so because it wanted to leave determination of supply and first-sale price to the market. "[A] federal decision to forgo regulation in a given area may imply an authoritative federal determination that the area is best left *un*regulated, and in that event would have as much preemptive force as a decision to regulate" (emphasis in original). Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n, 461 US, at 384, 76 L Ed 2d 1, 103 S Ct 1905. Cf. Machinists v. Wisconsin Employment Relations Comm'n, 427 US 132, 150-151, 49 L Ed 396, 96 S Ct 2548 (1976).

Id. at 422.

The Court found that the comprehensive scheme under the NGPA had *broader* preemptive effect than the regulatory scheme under the NGA. The Court stated that the NGPA "has been justly described as 'a comprehensive statute to govern future natural gas regulation.' " *Id.* at 420-21 (quoting Note, *Legislative History of the Natural Gas Policy Act*, 59 Texas L. Rev. 101, 116 (1980)). The Court explained further that:

> [T]he NGPA reflects a congressional belief that a new system of natural gas pricing was needed to balance supply and demand. See S Rep No 95-436, at 10. The new federal role is to "overse[e] a *national market price regulatory scheme.*" Haase, 16 Houston L Rev, at 1079; see S Rep No 95-436, at 21 (NGPA implements "a new commodity value pricing approach"). The NGPA therefore does not constitute a federal retreat from a comprehensive gas policy. Indeed, *the NGPA in some respects expanded federal control, since it granted FERC jurisdiction over the intrastate market for the first time.* See the Act's §§ 311 and 312, 15 USC §§ 3371 and 3372.

Id. at 421.

Northern Natural and *Transco* invalidated state application of ratable-take orders to natural gas purchases. *Northern Natural* prohibits their application to purchasers of regulated gas, while *Transco* prohibits their application to purchasers of deregulated gas. The basic evil addressed by the Court in both cases was application of a ratable-take rule to impose purchasing requirements on pipelines different from that dictated by market demand.

The Court's recent opinion in *Northwest Central Pipeline* does not detract from its holdings in *Transco* and *Northern Natural*. The Court in *Northwest Central Pipe-*

line found that Congress had not occupied the field in which the Kansas regulation at issue in that case operates. That regulation provides for the permanent cancellation of producers' entitlement to quantities of Kansas - Hugoton gas in order to govern the timing of gas production. The Court specifically acknowledged *Transco* as "a case in which we had declared the post-NGPA vitality of Northern Natural's holding that state regulations requiring purchasers to take gas rateably from producers are pre-empted by the federal regulatory power over pipelines' costs and purchasing patterns." 103 L.Ed.2d at 526. The Court distinguished *Transco* on the grounds that the Kansas regulation was not directed at pipelines but "to the behavior of gas producers, and regulates their rates of production as a means of exercising traditional state control over the conservation of natural resources and the protection of correlative rights." *Id.* at 529. The Court explained the distinction between preempted state regulations and permissible state regulations as follows:

> In both Northern Natural and Transco, States had crossed the dividing line so carefully drawn by Congress in NGA § 1(b) and retained in the NGPA, trespassing on federal territory by imposing purchasing requirements on interstate pipelines. In this case, on the contrary, Kansas has regulated production rates in order to protect producers' correlative rights —a matter firmly on the State's side of that dividing line.

Id. at 530.

The Texas Gas Market Demand Rule as applied in the unprecedented manner by the Texas Court of Appeals in this case is preempted by the NGPA. Appellants do not contest the validity of the Texas Gas Market

Demand Rule as it had been applied prior to the Texas Court of Appeals' decision in this case. All other courts and the Texas Railroad Commission have recognized that contractual obligations to pay for gas not taken are not superseded by the Texas Gas Market Demand Rule. A discussion of the interpretation of the Texas Gas Market Demand Rule by the Texas courts and the Texas Railroad Commission is contained in Appellants' Application for Writ of Error to the Texas Supreme Court. *See* Appendix, pp. 86-91. That discussion indicates that the Texas Court of Appeals adopted a novel construction and application of the Texas Gas Market Demand Rule that has been rejected by all other Texas courts and the Texas Railroad Commission.

The Texas Gas Market Demand Rule requires pipeline companies to limit their purchases of gas to the pipeline company's downstream market demand and to "ratably apportion" its purchases so that takes from various gas producing properties shall be made without discrimination among producers in the same field and "without unjust or unreasonable discrimination . . . among the various fields from which it purchases gas." Appendix, pp. 287, 288, 301.

Analysis of the two considerations in *Transco* and *Northern Natural* reveals that the Texas Gas Market Demand Rule as applied by the Texas Court of Appeals is preempted by the NGPA. First, as construed and applied by the Texas Court of Appeals, the Texas Gas Market Demand Rule trespasses on territory that the NGPA reserved for the federal government. Second, as construed and applied by the Texas Court of Appeals, the Texas Gas Market Demand Rule directly undermines the deregulatory regime established by Congress in the NGPA.

The Texas Gas Market Demand Rule as construed and applied by the Texas Court of Appeals trespasses on territory that the NGPA reserved for the federal government. Construction and application of the Texas Gas Market Demand Rule to relieve a purchaser of his take-or-pay obligations and liabilities under a gas purchase contract is a direct state regulation of the purchasing patterns of natural gas pipelines and the terms of that purchase. Such a construction and application invades the sphere exclusively assigned to the federal government in *Northern Natural, Transco,* and *Northwest Central Pipeline.* The Court stated in *Northwest Central Pipeline* that:

> Interstate pipelines operate within the field reserved under the NGA for federal regulation, buying gas in one State and transporting it for resale in another, so inevitably the States are pre-empted from directly regulating these pipelines in such a way as to affect their cost structures. Ibid. Likewise in Transco, in which we considered whether the rule in Northern Natural had survived deregulation of many interstate rates by the NGPA, we held that federal authority over transportation and rates—now expressed in a determination that rates should be unregulated and settled by market forces—continued to occupy the field and to preempt state rateable-take orders directed to pipelines and forcing upon them certain purchasing patterns. 474 US, at 422-424, 88 L Ed 2d 732, 106 S Ct 709.

103 L.Ed.2d at 530. The Texas Gas Market Demand Rule as applied by the Texas Court of Appeals invades an area of federal responsibility that has been occupied to the exclusion of the states. That federal role entails a deregulatory regime in which market forces, and not state or federal regulation, govern purchasing patterns of

natural gas pipelines, the price of natural gas, and the conditions of purchase.

The Texas Gas Market Demand Rule as applied by the Texas Court of Appeals undermines the deregulatory regime established by Congress in the NGPA. Professor Richard Pierce, in an article cited in *Northwest Central Pipeline,* 103 L.Ed.2d at 522, states: "In analyzing the constitutionality of any state regulation that arguably interferes with the federal goal of relying on market forces, a good starting point is to compare the results of state regulation with the results of a properly functioning market." Pierce, *State Regulation of Natural Gas In A Federally Deregulated Market: The Tragedy of the Commons Revisited,* 73 Cornell L. Rev. 15, 40-41 (1987). This Court has employed such a method of analysis and has recognized that take-or-pay provisions are part of, and indeed essential to, the operation of market forces.

In *Transco,* the Court stated that "take-or-pay provisions are standard industry wide. See Pierce, 68 Va L Rev, at 77-78; H R Rep No. 98-814, pp. 23-25, 133-134 (1984)." 474 U.S. at 423. In describing the take-or-pay contracts involved in *Transco,* the Court stated:

> In line with prevailing industry practice, the contracts contained "take-or-pay" provisions. These essentially required Transco either to accept currently a certain percentage of the gas each well was capable of producing, or to pay the contract price for that gas with a right to take delivery at some later time, usually limited in duration. Take-or-pay provisions enable sellers to avoid fluctuations in cash flow and are therefore thought to encourage investments in well development. See Pierce, Natural Gas Regula-

> tion, Deregulation, and Contracts, 68 Va L Rev 63, 77-79 (1982).

Id. at 412.

In *Northwest Central Pipeline*, the Court cited the parties' failure to negotiate a take-or-pay provision as evidence of the absence of market forces:

> The interstate pipelines generally entered into their current contracts to purchase Kansas-Hugoton gas at a time when the market was little developed and oligopsonic. These contracts usually provide for relatively low prices and do not contain "take-or-pay" provisions requiring the purchaser to pay for some minimum quantity of gas irrespective of whether it takes current delivery.

103 L.Ed.2d at 522.

Thus, the Texas Gas Market Demand Rule as construed and applied by the Texas Court of Appeals so as to relieve Appellee of its take-or-pay obligations directly undermines a standard contract provision that this Court has recognized is essential to the effective operation of a deregulated gas market.

No doubt exists that this Court's analysis of the role of take-or-pay provisions in a properly functioning market is correct. A take-or-pay clause is essential to the allocation of risk in a long-term gas contract and is a form of valuable consideration in such a contract. As stated in *Universal Resources Corp. v. Panhandle Eastern Pipeline Co.*, 813 F.2d 77, 80 (5th Cir. 1987):

> The purpose of the take-or-pay clause is to apportion the risks of natural gas production and sales between

> the buyer and seller. The seller bears the risk of production. To compensate seller for that risk, buyer agrees to take, or pay for if not taken, a minimum quantity of gas. The buyer bears the risk of market demand. The take-or-pay clause insures that if the demand for gas goes down, seller will still receive the price for the Contract Quantity delivered each year.

As explained in Medina, *The Take-Or-Pay Wars: A Further Status Report,* 41 Okla. L. Rev. 381, 384 (1988):

> [A] long-term gas contract by its very nature involves an exchange of valuable consideration. The pipeline is given the exclusive right to take the producer's gas for a term of years at an agreed price or pricing formula, thereby acquiring a contractually assured supply. The producer is assured a market, but relinquishes his right to sell gas to third-parties. The take-or-pay clause ensures the producer a minimum cash stream whether or not the gas is taken.

Had Appellee wanted to limit its takes of gas under its contract with Appellants during periods when gas was in surplus supply, it could have negotiated a market-out clause. The contract was drafted by sophisticated attorneys for clients with substantial experience in gas production and marketing. Appellee signed a contract for mandatory minimum takes during a period of inflated gas prices, because it gambled that the economy would remain favorable to gas supplies.

In addition, preservation of contractual expectations is essential for a properly functioning market. Government intervention to reallocate foreseeable business risks undermines contractual stability and creates a market distortion by discouraging parties from entering into long-term con-

tracts. *See* Medina, McKenzie, & Daniel, *Take or Litigate: Enforcing the Plain Meaning of the Take-or-Pay Clause in Natural Gas Contracts*, 40 Ark. L. Rev. 185, 218 (1986) ("A persuasive case can be made for the proposition that enforcement of take-or-pay clauses serves the national interest in encouraging producers of gas to enter into long-term contracts").

Thus, the Texas Gas Market Demand Rule as construed and applied by the Texas Court of Appeals to vitiate an arms-length, long-term gas supply contract directly conflicts with Congress' decision "to leave determination of supply and first-sale price to the market." 474 U.S. at 422.

ANR Pipeline Co. v. Corporation Commission of the State of Oklahoma, 860 F.2d 1571 (10th Cir. 1989), *cert. denied*, 490 U.S.____, 104 L.Ed.2d 435 (1989), involved an Oklahoma statute and rule which, like the Texas Gas Market Demand Rule, required "every purchaser of natural gas to purchase all of the natural gas offered for sale from a common reservoir (without discrimination in favor of one producer as against another, or in favor of one source of supply as against another), and, if the purchaser is unable to do so, then it must purchase natural gas from each producer ratably." 860 F.2d at 1581. The court held that "all state regulation of the *purchasing or taking* of natural gas by interstate pipeline companies has been pre-empted by the federal regulations contained in the Natural Gas Act and the Natural Gas Policy Act of 1978 (emphasis in original)." *Id.* The court concluded that the Oklahoma statute and rule "interfere with federal regulation of the purchase of natural gas" and "are pre-empted because they create an obstacle to full compliance with the objectives of the federal regulations." *Id.* at 1582.

A substantial federal question is raised in this case under the preemption doctrine applied by this Court in *Northern Natural, Transco,* and *Northwest Central Pipeline.* The ramifications of the Texas Court of Appeals' decision are far-reaching, because the effect of that court's reliance upon the government regulation clause is to hold that the Texas Gas Market Demand Rule relieves *all* pipeline purchasers in Texas of their take-or-pay obligations under all of their natural gas contracts in the absence of an express provision to the contrary. The opinion of the Texas Court of Appeals and the Texas Supreme Court's denial of Appellants' application for writ of error already have resulted, and will continue to result, in reliance by pipeline companies on the Texas Market Demand Rule as a complete defense to liability under the take-or-pay provisions of natural gas contracts.[2]

II.

This case also presents this Court with the substantial and novel question of whether application of state ratable-take regulations to relieve pipeline purchasers of take-or-pay obligations and liability under natural gas contracts violates the Commerce Clause of the United States Constitution. The Texas Court of Appeals' construction of the Texas Gas Market Demand Rule fails to pass the balancing test outlined by this Court in *Pike v. Bruce Church, Inc.,* 397 U.S. 137 (1970), and followed in later decisions. The Kansas regulations this Court upheld as valid under the Commerce Clause in *Northwest Central Pipeline* were "intended to protect correlative rights by

2. The use of the Texas Court of Appeals' opinion in other cases is discussed in Appellants' Motion for Rehearing before the Texas Supreme Court. *See* Appendix, pp. 127-28.

encouraging production of allowables, aimed at producers and *requiring nothing of purchasers.*" 103 L.Ed.2d at 536. The Texas Gas Market Demand Rule, however, applies directly to pipeline purchasers and as applied by the Texas Court of Appeals is a direct interference with the purchase of natural gas and invalid under the Commerce Clause.

The Commerce Clause analysis applies to this case even though the contract at issue is an intrastate gas sale contract. As recognized in *Transco*, the NGPA resulted in "unification of the interstate and intrastate markets," and now there is a "national natural gas market." 474 U.S. at 423-24. Congress "recognized the need to eliminate the distinction between the interstate and intrastate markets. Because the regulation-free intrastate market had imposed an opportunity cost on the interstate supply, Congress imposed price controls on intrastate gas in sections 105 and 106(b)." Note, *Legislative History of the Natural Gas Policy Act*, 59 Tex. L. Rev. 101, 120 (1980).

The authority given by the NGPA to FERC to regulate the price of "all first sales of natural gas irrespective of its interstate or intrastate character" was upheld in *State of Oklahoma v. Federal Energy Regulatory Commission*, 661 F.2d 832 (10th Cir. 1981), *cert. denied*, 457 U.S. 1105 (1982). The court there held that "the enactment of the NGPA is a constitutionally acceptable exercise of Congress' Commerce Clause power." 661 F.2d at 838. The basis of the court's holding, among other things, was that Congress may regulate wholly intrastate activities which have "a substantial economic effect on interstate commerce or when the intrastate activity is necessary to effectuate the interstate regulation"; "Congress had a

rational basis for determining that the unregulated intrastate market imposed a burden on interstate commerce"; and "Congress may preempt state conservation regulations which interfere with or burden interstate commerce." *Id.* at 834-35.

In considering the validity of state ratable-take rules such as the Texas Gas Market Demand Rule, there is no longer any valid reason for differentiating between interstate and intrastate pipelines. The Texas Gas Market Demand Rule does not distinguish between interstate and intrastate pipelines. Interstate and intrastate pipelines compete for the same gas and purchase from the same producers, the same fields, and even the same wells, and the maximum price of the first sales to them is regulated by FERC irrespective of the destination of the gas. Their purchasing practices and other actions have a definite impact upon each other and upon the national natural gas market which now exists as a result of the unification of the interstate and intrastate markets by the NGPA.

The Commerce Clause prevents states from erecting barriers to the free flow of interstate commerce even in the absence of congressional exercise of power to regulate commerce among states. As explained by this Court in *Raymond Motor Transportation, Inc. v. Rice,* 434 U.S. 429, 440 (1978):

> By its terms, the Commerce Clause grants Congress the power "[t]o regulate Commerce . . . among the several States. . . ." Long ago it was settled that even in the absence of a congressional exercise of this power, the Commerce Clause prevents the States from erecting barriers to the free flow of interstate commerce. Cooley v. Board of Wardens, 12 How

299, 13 L Ed 996 (1952); see Great A&P Tea Co. v. Cottrell, 424 US 366, 370-371, 47 L Ed 2d 55, 96 S Ct 923 (1976).

The Court then explained the *Pike* balancing test as follows:

> Our recent decisions make clear that the inquiry necessarily involves a sensitive consideration of the weight and nature of the state regulatory concern in light of the extent of the burden imposed on the course of interstate commerce. As the Court stated in Pike v. Bruce Church, Inc., 397 US 137, 142, 25 L Ed 174, 90 S Ct 844 (1970):
>
> > Although the criteria for determining the validity of statutes affecting interstate commerce have been variously stated, the general rule that emerges can be phrased as follows: Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. Huron Cement Co. v. Detroit, 362 U.S. 440, 443, [4 L Ed 2d 852, 80 S Ct 813, 78 ALR2d 1294]. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

This Court's Commerce Clause analysis has distinguished between state conservation regulations intended to protect correlative rights and aimed at producers and requiring nothing of purchasers and state conservation measures that are aimed at purchasers and the conditions

of natural gas purchases. In *Northwest Central Pipeline*, the Court held that a Kansas conservation "regulation intended to protect correlative rights by encouraging production of allowables, aimed at producers and requiring nothing of purchasers" did not violate the Commerce Clause. 103 L.Ed. at 536. The Court based its decision on the fact that the Kansas regulation is consistent with the NGA and the NGPA and does not disrupt commerce, and the statute "is an exercise of Kansas' traditional and congressionally recognized power over gas production." *Id.* at 537. In contrast, a Kansas ratable-take order directed at gas purchasers was invalidated partly on Commerce Clause grounds in *Northern Natural*. The Court explained that "our cases have consistently recognized a significant distinction, which bears directly upon the constitutional consequences, between conservation measures aimed directly at interstate purchasers and wholesalers for resale, and those aimed at producers and production." 372 U.S. at 94.

The Texas Gas Market Demand Rule as construed and applied by the Texas Court of Appeals violates the Commerce Clause, because (1) it is not an exercise of traditional state conservation functions and (2) it constitutes an impermissible burden on interstate commerce. The traditional conservation functions assigned to the states do not include the power to abrogate contract rights and obligations between parties to a natural gas contract between a producer and a gas pipeline purchaser.

In *Champlin Refining Co. v. Corporation Commission of Oklahoma*, 286 U.S. 210, 235 (1932), the Court upheld Olahoma's market demand prorationing statutes on the basis that they "apply only to production and not to

sales or transportation of crude oil or its products." The Court further stated that "[s]uch production is essentially a mining operation, and therefore, is not part of interstate commerce." *Id.* In both *Northern Natural* and *Northwest Central Pipeline*, the Court emphasized that state regulations aimed at purchasers are not within the traditional state conservation function and do not pass constitutional muster. The Court stated in *Northern Natural:*

> [A] purpose, however legitimate, to conserve natural resources, does not warrant *direct* interference by the States with the prices of natural gas wholesales in interstate commerce, Cities Service Gas Co. v. State Corp. Com. 355 US 391, 2 L ed 2d 355, 78 S Ct 381; Michigan Wisconsin Pipe Line Co. v. Corporation Com. 355 US 425, 2 L ed 2d 412, 78 S Ct 409 (emphasis in original).

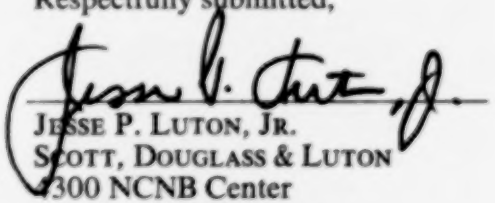
372 U.S. at 93.

Interstate commerce is impermissibly burdened by the Texas Gas Market Demand Rule as construed and applied by the Texas Court of Appeals. Take-or-pay provisions are an essential part of market forces, and their enforcement is essential for contractual stability and encouragement of long-term natural gas contracts. *See supra*, p. 23. The application of the Texas Gas Market Demand Rule to vitiate a take-or-pay provision is thus a direct and serious burden on interstate commerce. This burden is especially significant in light of Congress' determination in the NGPA that the purchase of natural gas be regulated by market forces and not by state or federal regulation.

CONCLUSION

For these reasons, this Court should note probable jurisdiction of this appeal.

Respectfully submitted,



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December 7, 1989

CERTIFICATE OF SERVICE

I hereby certify that Appellants' Jurisdictional Statement was served on the Appellee by depositing it in a United States post office or mailbox, with first class postage prepaid, on the 7th day of December, 1989, addressed to Appellee's counsel of record as follows:

Mr. J. Clifford Gunter
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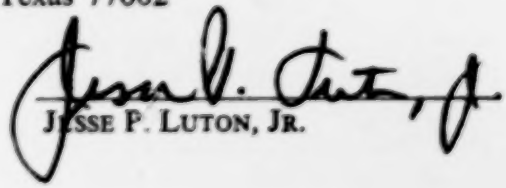

JESSE P. LUTON, JR.

Supreme Court, U.S.
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89-935

NO. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants

v.

VALERO TRANSMISSION COMPANY,
Appellee

On Appeal From The Court of Appeals For The Fourth Supreme Judicial District of Texas

APPENDIX TO THE JURISDICTIONAL STATEMENT

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COURT OF APPEALS
FOURTH SUPREME JUDICIAL DISTRICT
OF TEXAS
SAN ANTONIO

OPINION

Appeal No. 04-87-00380-CV

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants

v.

VALERO TRANSMISSION COMPANY,
Appellee

Appeal from the 112th District Court of Sutton County

Trial Court No. 2,930

Honorable Bob Parks, Judge Presiding

Opinion by: Alfonso Chapa, Associate Justice

Sitting: Carlos C. Cadena, Chief Justice, Concur in Result. Blair Reeves, Associate Justice, Concur in Result. Alfonso Chapa, Associate Justice.

Delivered and filed: March 31, 1988.

AFFIRMED

This is an appeal of part of a final judgment following a jury trial. The judgment arose from a suit filed by appellant Lively Exploration Company (Lively) against appellee Valero Transmission Company (Valero) for a breach of a gas purchase contract. Lively alleged that

Valero breached its obligations under the contract by failing to take delivery of and pay for the Daily Contract Quantity of natural gas during certain contract years or pay for such Daily Contract Quantity of natural gas, whether taken or not. In accordance with the findings of the jury, among other things, the judgment ordered that Lively take nothing on its claim for breach of the take-or-pay provisions of the contract. It is this part of the judgment which is sought to be reversed by this appeal. We affirm.

The issues before us are:

1) whether the court erred in admitting evidence of the Railroad Commission's Gas Market Demand Rule;

2) whether the court erred in including an instruction on the Gas Market Demand Rule;

3) whether the court erred in its definition of the term "deliverability";

4) whether the court's instructions to Special Issue No. 2 were prejudicial comments on the weight of the evidence;

5) whether the court erred in conditionally submitting Special Issue No. 3;

6) whether there was no evidence to support the jury findings on the breach of contract;

7) whether there was insufficient evidence to support the jury findings on the breach of contract; and

8) whether the jury findings on the breach of contract were against the great weight and preponderance of the credible evidence.

In the first two points of error, Lively contends that the trial court erred in admitting evidence of the Texas Railroad Commission's Gas Market Demand Rule and then including the said rule in the charge. Although Lively does not contend the evidence is irrelevant or immaterial, it argues that "the gas market demand rule does not affect the rights and obligations of the parties to the contract by relieving Valero of its obligation to pay for this minimum quantity of gas provided by the contract."

Lively alleged that Valero breached that part of the contract which had a "take-or-pay" provision:

> 5.3 Subject to the other provisions hereof, Buyer agrees to purchase and pay for (or, if Buyer's performance hereunder is not excused by other provisions of this agreement, pay for, if available, whether taken or not) during the days of each contract year of the term hereof a Daily Contract Quantity of gas from Seller's Lands and Leases in the Contract Area equal to ninety percent (90%) of Seller's daily Deliverability of gas hereunder. . . .

The obligations of Valero under the "take-or-pay" provision of the contract are clearly controlled by the "Daily Contract Quantity" and the "Deliverability" of the gas.

Under Article I of the contract and entitled "Definitions" we find the following:

> (e) The term "Daily Contract Quantity" means the quantity of gas per day, averaged over each contract year, which Buyer is required to take from Seller hereunder at the point of delivery specified in this Agreement.
>
> (j) The term "Deliverability" means that quantity of gas which Seller has available for delivery from

> the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, *but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.* Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects to take hereunder up to the maximum quantity which in accordance with good engineering and gas production practice can be produced from Seller's wells in the field. (Emphasis added)

Further, the contract includes a clause subjecting the agreement as follows:

> AGREEMENT SUBJECT TO LAWS
>
> 13.1 This Agreement is made subject to all valid applicable federal and state laws or city ordinances, and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction.

Evidence is admissible if it is "relevant and material; it must tend to prove or disprove some issue in the case." *Dallas Railway & Terminal Company v. Oehler,* 156 Tex. 488, 296 S.W.2d 757, 759 (1956); *Sims v. Dempsey-Tegler & Company, Inc.*, 487 S.W.2d 824, 827-28 (Tex. Civ. App.—San Antonio 1972, no writ). It is uncontradicted that the Texas Railroad Commission has regula-

tory jurisdiction over drilling, production, transportation, and use of natural gas in Texas. It is also uncontradicted that the Gas Market Demand Rule which was applicable to Lively and Valero, was promulgated by the Texas Railroad Commission as a tool to avoid "waste" by determining the overall quantity of natural gas which should be produced in Texas in a given month and to assure fairness in the proration between the different producers. Thus, the rule was relevant and material towards the issue of the quantity of gas which Lively had available for delivery, or in terms of the contract, Lively's "daily Deliverability of gas."

Since the application of the Gas Market Demand Rule tended to disprove that there was a breach of the "take-or-pay" provision, it was admissible. *Dallas Railway & Terminal Company v. Oehler*, 296 S.W.2d at 759.

Next, Lively does not contend that the application of the Gas Market Demand Rule to Lively and Valero in the charge was erroneous, but that the charge should not have included the rule because it did not relieve Valero of its contractual obligation. Lively apparently views the inclusion of the Gas Market Demand Rule in the evidence and charge as evidence of and instructions about an impermissible affirmative defense of Valero. However, the real issue here is whether the rule was relevant and material to prove or disprove that there was a breach of the "take-or-pay" provision of the contract as alleged by Lively. Having concluded that the Rule was relevant and material, we fail to see how its inclusion in the charge was harmful error. The first two points are overruled.

In the next two points of error, Lively complains of the court's definition of "Deliverability."

An appellant cannot complain that the court has adopted his definition in the charge. *MacFadden Publications v. Wilson*, 121 S.W.2d 430, 433 (Tex. Civ. App.—El Paso 1938, writ ref'd). A party may not complain of error for the first time on appeal, *State v. Lackey*, 576 S.W.2d 685, 688-89 (Tex. Civ. App.—San Antonio 1979, writ ref'd n.r.e.) and an objection to an instruction must be specific and clearly pointed out, or it is waived. *Southwestern Bell Telephone Co. v. Ramsey*, 542 S.W.2d 466, 467 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.).

The record reflects that the definition of "Deliverability" in the charge was the same one submitted by Lively. Further, although Lively made a general objection to Special Issue No. 2, no specific or clear objection was leveled at the definition of "Deliverability," which was identical to the one submitted to the court by Lively and also found in the contract. The points of error are overruled.

Lively next complains that the instructions to Special Issue No. 2 were prejudicial comments on the weight of the evidence. We disagree.

An impermissible comment on the weight of the evidence occurs, when after examining the entire charge, it is determined that the judge assumed the truth of a material controverted fact, or exaggerates, minimizes, or withdraws some pertinent evidence from the jury's consideration. The comment must also be one that probably caused the rendition of an improper judgment. *Alvarez v. Missouri-Kansas-Texas Railroad Co.*, 683 S.W.2d 375, 377 (Tex. 1984); *Hirdler v. Boyd*, 702 S.W.2d 727, 730 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.). Incidental comments are permissible when necessary or proper as part of an explanatory instruction or definition.

Board of Regents of North Texas State University v. Denton Construction Co., 652 S.W.2d 588, 595 (Tex. App.—Fort Worth 1983, writ ref'd n.r.e.); *Hirdler v. Boyd*, 702 S.W.2d 730.

The first instructions that Lively complains of are:

> The term market demand means that amount of gas needed for current consumption.
>
> You are instructed that the production, transportation, or use of gas in a manner, in an amount, or under conditions which constitute waste is unlawful and is prohibited.
>
> You are instructed that the term "waste" includes the production of gas in excess of transportation or market facilities or reasonable market demand for the type of gas produced.

Although Lively does not contend the instructions are an inaccurate statement of the law, it contends the instructions were irrelevant. Lively however, fails to explain how the instructions probably caused the rendition of an improper judgment.

The instructions complained of are relevant in explaining the basis of the Gas Market Demand Rule which we have already concluded was relevant and material. We hold that the instructions were relevant, not a comment on the weight of the evidence, and did not cause the rendition of an improper judgment.

The next instruction to Special Issue No. 2 which Lively complains of is:

> You are instructed that the Contract provides that subject to its other provisions, Valero shall have the right to purchase such quantity of gas per day as

> Valero may from day to day elect to purchase up to the total quantity per day which the wells are capable of producing when produced at their respective maximum efficient rates of flow, in Lively's sole judgment reasonably exercised, or at their respective allowable rates of flow under applicable orders, rules, regulations or laws, whichever is the lesser rate of flow.

Lively asserts that the instruction was unnecessary, constituted a comment on the weight of the evidence, and caused the rendition of an improper judgment.

It is uncontradicted that the instruction tracked Article V, § 5.2 of the contract which had been received in evidence. But Lively contends that an unnecessary instruction may amount to a reversible error, and cites *First International Bank in San Antonio v. Roper Corp.*, 686 S.W.2d 602 (Tex. 1985) and *Lemos v. Montez*, 680 S.W.2d 798 (Tex. 1984). However, both of these cases involve causes of action whose issues and instructions are specifically set out in the Texas Pattern Jury Charges which were approved with vigor by the Supreme Court. In *Lemos*, the Supreme Court rejected any additions to the correct definition of unavoidable accident in the Pattern Jury Charge stating:

> This Court has not indicated to the bench and bar that the definition should be embellished with the addendum.

Lemos v. Montez, 680 S.W.2d at 801.

In *First International Bank of San Antonio*, the Supreme Court again rejected any additions to the Texas Pattern Jury Charge special issue and instructions on design defects by stating:

> We explicitly approved the Texas Pattern Jury Charges special issue and instruction on design defect, but again stated that additional instructions which single out balancing factors are improper and comments on the case.

First International Bank in San Antonio v. Roper Corp., 686 S.W.2d at 604.

This case however, does not involve approved issues and instructions of the Texas Pattern Jury Charges and must be viewed accordingly. Lively complains that this unnecessary instruction diverted the attention of the jury from the central issue. In deciding whether this instruction was unnecessary and probably caused a rendition of an improper judgment, we must consider the charge as a whole. *Alvarez v. Missouri-Kansas-Texas Railroad Co.*, 683 S.W.2d at 377; *Hirdler v. Boyd*, 702 S.W.2d at 730.

We note that the instruction complained of is only one of a number of explanatory instructions generally tracking those parts of the contract which the judge felt were necessary to aid the jury in answering Special Issue No. 2. Lively contends that the initial language of the instruction could have misled the jury away from the real obligations of Valero under the "take-or-pay" provision. To see clearly what adverse effect, if any, this particular instruction had on Special Issue No. 2, we must view the entire set of instructions as set out in the charge:

> SPECIAL ISSUE NO. 2
>
> Do you find that Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)?
>
> (Answer "yes" or "no".)
>
> Answer no.

INSTRUCTION NO. 2

You are instructed that the total quantity of gas which Valero was obligated, if not excused under the Contract, to take and pay for, or pay for if not taken, for each of the Contract Years, is that volume of gas equal to the Daily Contract Quantity in effect during the Contract Year multiplied by the number of days during the Contract Year for which such Daily Contract Quantity was in effect.

You are instructed that the term "Daily Contract Quantity" is defined by the Contract to be that quantity of gas equal to ninety percent (90%) of Lively's daily Deliverability under the Contract.

You are instructed that the Contract provides that subject to its other provisions, Valero shall have the right to purchase such quantity of gas per day as Valero may from day to day elect to purchase up to the total quantity per day which the wells are capable of producing when produced at their respective maximum efficient rates of flow, in Lively's sole judgment reasonably exercised, or at their respective allowable rates of flow under applicable orders, rules, regulations or laws, whichever is the lesser rate of flow.

You are also instructed that Lively's daily "Deliverability" is defined by the Contract to be that quantity of gas which Lively had available for delivery from the Lands and Leases to Valero during each day in conformity with the requirements of the Contract, at a constant rate of flow, when Lively's wells were not produced in excess of their maximum efficient rate of flow, but not in excess of the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.

The term market demand means that amount of gas needed for current consumption.

You are instructed that in the production, transportation, or use of gas in a manner, in an amount, or under conditions which constitute waste is unlawful and is prohibited.

You are instructed that the term "waste" includes the production of gas in excess of transportation or market facilities or reasonable market demand for the type of gas produced.

You are instructed that the word "ratably" means proportionately. Under the Gas Market Demand Rule Valero shall nominate on Form T-3 a total quantity of gas equal to its downstream market demand plus shrinkage, line loss, plant fuel, and compressor use. Valero shall ratably apportion its actual take from all gas wells connected to its system so that takes from various gas producing properties shall be made without discrimination in favor of one producer or person as against another in the same field and without unjust or unreasonable discrimination between fields.

You are instructed that under the Gas Market Demand Rule, Lively is required to submit the following information to the Railroad Commission:

(1) Form P-4 Producer's Certificate of Compliance (on which the gatherer, the first purchaser, and the initial nominator shall be named).

(2) Form G-10 Gas Well Status Report (semiannually unless otherwise required by special field rules).

(3) Form G-7 Producer's Forecast (monthly as required by Statewide Rule 30 and in accordance with instructions on Form G-7).

> Lively shall forecast a total quantity of gas not to exceed the amount of gas Lively expects to consume plus the amount of gas Lively expects to deliver to Valero as indicated by information provided by Valero pursuant to the Market Demand Rule.

We readily note that the instruction complained of was not unduly stressed, and is found in the middle of numerous instructions. The instruction complained of speaks of "rights to purchase" of Valero and not of "obligations" of Valero which is the basis of this cause of action. Further, the very first instruction of the series sets out clearly that portion of the contract which Lively asserts has been breached and which clearly sets out the "obligations" of Valero. Considering the entire set of instructions of Special Issue No. 2 and the entire charge, we hold that the complained of instruction was not a comment on the weight of the evidence, and probably did not cause the rendition of an improper judgment. The point of error is overruled.

Lively next contends the court erred in conditionally submitting Special Issue No. 3. The complaint is based on the contention that Special Issue No. 2 was merely an evidentiary issue and the controlling issue was Special Issue No. 3. We disagree.

We note with interest Lively's statement in its brief under the title "Preliminary Statement":

> Lively alleged that Valero breached it's obligations under the contract by failing to take delivery of and pay for the Daily Contract Quantity of natural gas . . . or pay for such Daily Contract Quantity of natural gas, whether taken or not. . . .

Thus, Lively admits that whether Valero failed to take and pay or just failed to pay the Daily Contract Quantity of gas was critical to their cause of action.

Special Issue Nos. 2 and 3 with the conditional instruction read:

SPECIAL ISSUE NO. 2

> Do you find that Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)?
>
> Answer Special Issue No. 3 only if you answered Special Issue No. 2 "yes," otherwise go to Special Issue No. 4.

SPECIAL ISSUE NO. 3

> What sum of money, if any, if paid now in cash, do you find to be due and owing to Lively under the Contract?

Where the court submits the controlling issues raised by the pleadings and the evidence, the case shall not be reversed because of the failure to submit other various phases or different shades of the same issue. TEX. R. CIV. P. 279; *Holmes v. J.C. Penney Co.*, 382 S.W.2d 472, 473 (Tex. 1964). The court here fairly submitted Special Issue No. 2, which was the controlling issue, and properly conditionally submitted Special Issue No. 3, which was the damage issue. The point of error is overruled.

In the last three points of error, Lively contends there is no evidence or insufficient evidence to support the jury's answer to Special Issue No. 2, and that the jury's answer to Special Issue No. 2 was against the great weight and preponderance of the evidence. Lively, after conceding

that the evidence of the Gas Market Demand Rule supports the jury finding in Special Issue No. 2, contends it has no probative value as a matter of law because the Gas Market Demand Rule does not abrogate Valero's obligations under the contract. Therefore, Lively would have us ignore this evidence. We disagree.

A no evidence point is a question of law and we can consider only that evidence and the reasonable inference therefrom which viewed in its most favorable light support the jury finding and we must reject all evidence or reasonable inferences to the contrary. *Glover v. Texas General Indemnity Co.,* 619 S.W.2d 400, 401 (Tex. 1981); *McClure v. Allied Stores of Texas, Inc.,* 608 S.W.2d 901, 904 (Tex. 1980). In determining the sufficiency of the evidence "the court of appeals must consider and weigh all the evidence, and should set aside the verdict only if it is so contrary to the overwhelming weight of the evidence as to be clearly wrong and unjust." *Cain v. Bain,* 709 S.W.2d 175, 176 (Tex. 1986); *Pool v. Ford Motor Co.,* 715 S.W.2d 629 (Tex. 1986). However, we must always remain cognizant that it is for the jury to judge the credibility of the witnesses, to assign the weight to be given their testimony, and to resolve any conflicts or inconsistencies in the evidence. *Town & Country Mobile Homes, Inc. v. Bilyeu,* 694 S.W.2d 651, 656 (Tex. App.—Fort Worth 1985, no writ); *Precision Homes, Inc. v. Cooper,* 671 S.W.2d 924, 929 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.). Therefore, in determining the sufficiency of the evidence, appellate courts must recognize from the verdict of the jury what the jury, in their discretion, chose to believe. In so doing, we must accept the jury's resolution of any conflicts or inconsistencies in the evidence and not attempt to substitute our

judgment for theirs. *Pool v. Ford Motor Co.*, 715 S.W.2d at 634.

The record reflects extensive testimony pertaining to the Gas Market Demand Rule and its direct effect upon the "Daily Contract Quantity" and "Deliverability" clauses of the contract. The testimony disclosed essentially that the rule was promulgated by the Texas Railroad Commission, who had regulatory jurisdiction over the critical aspects of the contract, and that Valero purchased from Lively the maximum "Daily Contract Quantity" of gas which was legally "Deliverable" by Lively under the dictates of the Gas Market Demand Rule. Lively attempted to establish that "Deliverability" under the contract was strictly based on G-10 volumes and that the Gas Market Demand Rule had no application to Valero's obligations under the contract.

The jury verdict clearly reveals that the jury chose to believe Valero's theory and that there was no breach of the "take-or-pay" clause as alleged by Lively. Considering all the evidence under the appropriate standards of review, we cannot conclude that the verdict "is so contrary to the overwhelming weight of the evidence as to be clearly wrong and unjust." *Cain v. Bain*, 709 S.W.2d at 176. The last points of error are overruled.

The judgment of the trial court is affirmed.

/s/ ALFONSO CHAPA,
Associate Justice

PUBLISH.

LIVELY EXPLORATION COMPANY,
et al., Appellants,

v.

VALERO TRANSMISSION COMPANY,
Appellee.

No. 04-87-00380-CV.

Court of Appeals of Texas,
San Antonio.

May 18, 1988.

Writ of Error June 16, 1988.

Natural gas producer sued purchaser for amounts allegedly due under "take-or-pay" provisions of contract. Following jury trial before the 112th District Court, Sutton County, Bob Parks, J., judgment was entered, inter alia, ordering that producer take nothing on its claim for breach of contract provision. Producer appealed. The Court of Appeals, Chapa, J., held that: (1) Texas Railroad Commission's gas market demand rule was material and relevant to issues and thus was properly admitted into evidence and included in jury charge; (2) court's instructions with respect to controlling special issue, in which jury was asked whether purchaser failed to take or pay for amount of gas equal to its contract obligations, were not prejudicial comments on weight of evidence; (3) court did not err in conditionally submitting special jury issue on damages; and (4) jury findings were sufficient under no evidence or insufficiency of evidence tests.

Affirmed.

Jesse P. Luton, Jr., James P. Pennington, Scott, Douglass & Luton, Houston, Frank Douglass, Christopher Fuller, Scott, Douglass & Luton, Austin, for appellants.

J. Clifford Gunter, Carrin F. Patman, Laura B. Herring, Gregory C. King, Bracewell & Patterson, Houston, for appellee.

Before CADENA, C.J. and REEVES and CHAPA, JJ.

ON APPELLANT'S MOTION FOR REHEARING

CHAPA, Justice.

Appellant's motion for rehearing is denied, however, the opinion of this Court dated March 31, 1988, is withdrawn, and the following opinion is substituted.

This is an appeal of part of a final judgment following a jury trial. The judgment arose from a suit filed by appellant Lively Exploration Company (Lively) against appellee Valero Transmission Company (Valero) for breach of a gas purchase contract. Lively alleged that Valero breached its obligations under the contract by failing to take delivery of and pay for the Daily Contract Quantity of natural gas during certain contract years or pay for such Daily Contract Quantity of natural gas, whether taken or not. In accordance with the findings of the jury, among other things, the judgment ordered that Lively take nothing on its claim for breach of the take-or-pay provisions of the contract. It is this part of the judgment which is sought to be reversed by this appeal. We affirm.

The issues before us are:

1) whether the court erred in admitting evidence of the Railroad Commission's Gas Market Demand Rule;

2) whether the court erred in including an instruction on the Gas Market Demand Rule;

3) whether the court erred in its definition of the term "deliverability";

4) whether the court's instructions to Special Issue No. 2 were prejudicial comments on the weight of the evidence;

5) whether the court erred in conditionally submitting Special Issue No. 3;

6) whether there was no evidence to support the jury findings on the breach of contract;

7) whether there was insufficient evidence to support the jury findings on the breach of contract; and

8) whether the jury findings on the breach of contract were against the great weight and preponderance of the credible evidence.

In the first two points of error, Lively contends that the trial court erred in admitting evidence of the Texas Railroad Commission's Gas Market Demand Rule and then including the said rule in the charge. Although Lively does not contend the evidence is irrelevant or immaterial, it argues that "the gas market demand rule does not affect the rights and obligations of the parties to the contract by relieving Valero of its obligation to pay for this minimum quantity of gas provided by the contract."

Lively alleged that Valero breached that part of the contract which had a "take-or-pay" provision:

> 5.3 Subject to the other provisions hereof, Buyer agrees to purchase and pay for (or, if Buyer's performance hereunder is not excused by other provi-

> sions of this agreement, pay for, if available, whether taken or not) during the days of each contract year of the term hereof a Daily Contract Quantity of gas from Seller's Lands and Leases in the Contract Area equal to ninety percent (90%) of Seller's daily Deliberability of gas hereunder. . . .

The obligations of Valero under the "take-or-pay" provision of the contract are clearly controlled by the "Daily Contract Quantity" and the "Deliverability" of the gas.

Under Article I of the contract and entitled "Definitions" we find the following:

> (e) The term "Daily Contract Quantity" means the quantity of gas per day, averaged over each contract year, which Buyer is required to take from Seller hereunder at the point of delivery specified in this Agreement.
>
> (j) The term "Deliverability" means that quantity of gas which Seller has available for delivery from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, *but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.* Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects to take hereunder up to the maximum quantity which in accordance with good engineering and gas production practice can be

produced from Seller's wells in the field. (Emphasis added)

Further, the contract includes a clause subjecting the agreement as follows:

AGREEMENT SUBJECT TO LAWS

13.1 This Agreement is made subject to all valid applicable federal and state laws or city ordinances, and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction.

Evidence is admissible if it is "relevant and material; it must tend to prove or disprove some issue in the case." *Dallas Railway & Terminal Company v. Oehler*, 156 Tex. 488, 296 S.W. 757, 759 (1956); *Sims v. Dempsey-Tegler & Company, Inc.*, 487 S.W.2d 824, 827-28 (Tex. Civ. App.—San Antonio 1972, no writ). It is uncontradicted that the Texas Railroad Commission has regulatory jurisdiction over drilling, production, transportation, and use of natural gas in Texas. It is also uncontradicted that the Gas Market Demand Rule which was applicable to Lively and Valero, was promulgated by the Texas Railroad Commission as a tool to avoid "waste" by determining the overall quantity of natural gas which should be produced in Texas in a given month and to assure fairness in the proration between the different producers. Thus, the rule was relevant and material towards the issue of the quantity of gas which Lively had available for delivery, or in terms of the contract, Lively's "daily Deliverability of gas."

Since the application of the Gas Market Demand Rule tended to disprove that there was a breach of the "take-

or-pay" provision, it was admissible. *Dallas Railway & Terminal Company v. Oehler,* 296 S.W.2d at 759.

Next, Lively does not contend that the application of the Gas Market Demand Rule to Lively and Valero in the charge was erroneous, but that the charge should not have included the rule because it did not relieve Valero of its contractual obligation. However, the real issue here is whether the rule was relevant and material to prove or disprove that there was a breach of the "take-or-pay" provision of the contract as alleged by Lively. Having concluded that the rule was relevant and material, we fail to see how its inclusion in the charge was harmful error. The first two points are overruled.

In the next two points of error, Lively complains of the court's definition of "Deliverability."

An appellant cannot complain that the court has adopted his definition in the charge. *MacFadden Publications v. Wilson,* 121 S.W.2d 430, 433 (Tex. Civ. App. —El Paso 1938, writ ref'd). A party may not complain of error for the first time on appeal, *State v. Lackey,* 576 S.W.2d 685, 688-89 (Tex. Civ. App.—San Antonio 1979, writ ref'd n.r.e.) and an objection to an instruction must be specific and clearly pointed out, or it is waived. *Southwestern Bell Telephone Co. v. Ramsey,* 542 S.W.2d 466, 467 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.).

The record reflects that the definition of "Deliverability" in the charge was the same one submitted by Lively. Further, although Lively made a general objection to Special Issue No. 2, no specific or clear objection was leveled at the definition of "Deliverability" which was identical to the one submitted to the court by Lively

and also found in the contract. The points of error are overruled.

Lively next complains that the instructions to Special Issue No. 2 were prejudicial comments on the weight of the evidence. We disagree.

An impermissible comment on the weight of the evidence occurs, when after examining the entire charge, it is determined that the judge assumed the truth of a material controverted fact, or exaggerates, minimizes, or withdraws some pertinent evidence from the jury's consideration. The comment must also be one that probably caused the rendition of an improper judgment. *Alvarez v. Missouri-Kansas-Texas Railroad Co.*, 683 S.W. 2d 375, 377 (Tex. 1984); *Hirdler v. Boyd*, 702 S.W.2d 727, 730 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.). Incidental comments are permissible when necessary or proper as part of an explanatory instruction or definition. *Board of Regents of North Texas State University v. Denton Construction Co.*, 652 S.W.2d 588, 595 (Tex. App.—Fort Worth 1983, writ ref'd n.r.e.); *Hirdler v. Boyd*, 702 S.W.2d at 730.

The first instructions that Lively complains of are:

> The term market demand means that amount of gas needed for current consumption.
>
> You are instructed that the production, transportation, or use of gas in a manner, in an amount, or under conditions which constitute waste is unlawful and is prohibited.
>
> You are instructed that the term "waste" includes the production of gas in excess of transportation or market facilities or reasonable market demand for the type of gas produced.

Although Lively does not contend the instructions are an inaccurate statement of the law, it contends the instructions were irrelevant. Lively however, fails to explain how the instructions probably caused the rendition of an improper judgment.

The instructions complained of are relevant in explaining the basis of the Gas Market Demand Rule which we have already concluded was relevant and material. We hold that the instructions were relevant, not a comment on the weight of the evidence, and did not cause the rendition of an improper judgment.

The next instruction to Special Issue No. 2 which Lively complains of is:

> You are instructed that the Contract provides that subject to its other provisions, Valero shall have the right to purchase such quantity of gas per day as Valero may from day to day elect to purchase up to the total quantity per day which the wells are capable of producing when produced at their respective maximum efficient rates of flow, in Lively's sole judgment reasonably exercised, or at their respective allowable rates of flow under applicable orders, rules, regulations or laws, whichever is the lesser rate of flow.

Lively asserts that the instruction was unnecessary, constituted a comment on the weight of the evidence, and caused the rendition of an improper judgment.

It is uncontradicted that the instruction tracked Article V, § 5.2 of the contract which had been received in evidence. But Lively contends that an unnecessary instruction may amount to a reversible error, and cites *First International Bank in San Antonio v. Roper Corp.*, 686

S.W.2d 602 (Tex. 1985) and *Lemos v. Montez,* 680 S.W.2d 798 (Tex. 1984). However, both of these cases involve causes of action whose issues and instructions are specifically set out in the Texas Pattern Jury Charges which were approved with vigor by the Supreme Court. In *Lemos,* the Supreme Court rejected any additions to the correct definition of unavoidable accident in the Pattern Jury Charge stating:

> This Court has not indicated to the bench and bar that the definition should be embellished with the addendum.

Lemos v. Montez, 680 S.W.2d at 801.

In *First International Bank of San Antonio,* the Supreme Court again rejected any additions to the Texas Pattern Jury Charge special issue and instructions on design defects by stating:

> We explicitly approved the Texas Pattern Jury Charges special issue and instruction on design defect, but again stated that additional instructions which single out balancing factors are improper and comments on the case.

First International Bank in San Antonio v. Roper Corp., 686 S.W.2d at 604.

This case however, does not involve approved issues and instructions of the Texas Pattern Jury Charges and must be viewed accordingly. Lively complains that this unnecessary instruction diverted the attention of the jury from the central issue. In deciding whether this instruction was unnecessary and probably caused a rendition of an improper judgment, we must consider the charge as a

whole. *Alvarez v. Missouri-Kansas-Texas Railroad Co.*, 683 S.W.2d at 377; *Hirdler v. Boyd*, 702 S.W.2d at 730.

We note that the instruction complained of is only one of a number of explanatory instructions generally tracking those parts of the contract which the judge felt were necessary to aid the jury in answering Special Issue No. 2. Lively contends that the initial language of the instruction could have misled the jury away from the real obligations of Valero under the "take-or-pay" provision. To see clearly what adverse effect, if any, this particular instruction had on Special Issue No. 2, we must view the entire set of instructions as set out in the charge:

SPECIAL ISSUE NO. 2

Do you find that Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)?

(Answer "yes" or "no".)

Answer no.

INSTRUCTION NO. 2

You are instructed that the total quantity of gas which Valero was obligated, if not excused under the Contract, to take and pay for, or pay for if not taken, for each of the Contract Years, is that volume of gas equal to the Daily Contract Quantity in effect during the Contract Year multiplied by the number of days during the Contract Year for which such Daily Contract Quantity was in effect.

You are instructed that the term "Daily Contract Quantity" is defined by the Contract to be that quantity of gas equal to ninety percent (90%) of Lively's daily Deliverability under the Contract.

You are instructed that the Contract provides that subject to its other provisions, Valero shall have the right to purchase such quantity of gas per day as Valero may from day to day elect to purchase up to the total quantity per day which the wells are capable of producing when produced at their respective maximum efficient rates of flow, in Lively's sole judgment reasonably exercised, or at their respective allowable rates of flow under applicable orders, rules, regulations or laws, whichever is the lesser rate of flow.

You are also instructed that Lively's daily "Deliverability" is defined by the Contract to be that quantity of gas which Lively had available for delivery from the Lands and Leases to Valero during each day in conformity with the requirements of the Contract, at a constant rate of flow, when Lively's wells were not produced in excess of their maximum efficient rate of flow, but not in excess of the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.

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You are instructed that the term "waste" includes the production of gas in excess of transportation or market facilities or reasonable market demand for the type of gas produced.

You are instructed that the word "ratably" means proportionately. Under the Gas Market Demand Rule Valero shall nominate on Form T-3 a total

quantity of gas equal to its downstream market demand plus shrinkage, line loss, plant fuel, and compressor use. Valero shall ratably apportion its actual take from all gas wells connected to its system so that takes from various gas producing properties shall be made without discrimination in favor of one producer or person as against another in the same field and without unjust or unreasonable discrimination between fields.

You are instructed that under the Gas Market Demand Rule, Lively is required to submit the following information to the Railroad Commission:

(1) Form P-4 Producer's Certificate of Compliance (on which the gatherer, the first purchaser, and the initial nominator shall be named).

(2) Form G-10 Gas Well Status Report (semi-annually unless otherwise required by special field rules).

(3) Form G-7 Producer's Forecast (monthly as required by Statewide Rule 30 and in accordance with instructions on Form G-7). Lively shall forecast a total quantity of gas not to exceed the amount of gas Lively expects to consume plus the amount of gas Lively expects to deliver to Valero as indicated by information provided by Valero pursuant to the Market Demand Rule.

We readily note that the instruction complained of was not unduly stressed, and is found in the middle of numerous instructions. The instruction complained of speaks of "rights to purchase" of Valero and not of "obligations" of Valero which is the basis of this cause of action. Further, the very first instruction of the series sets out clearly that portion of the contract which Lively asserts has been breached and which clearly sets out the "obli-

gations" of Valero. Considering the entire set of instructions of Special Issue No. 2 and the entire charge, we hold that the complained of instruction was not a comment on the weight of the evidence, and probably did not cause the rendition of an improper judgment. The point of error is overruled.

Lively next contends the court erred in conditionally submitting Special Issue No. 3. The complaint is based on the contention that Special Issue No. 2 was merely an evidentiary issue and the controlling issue was Special Issue No. 3. We disagree.

We note with interest Lively's statement in its brief under the title "Preliminary Statement":

> Lively alleged that Valero breached it's obligations under the contract by failing to take delivery of and pay for the Daily Contract Quantity of natural gas . . . or pay for such Daily Contract Quantity of natural gas, whether taken or not. . . .

Thus, Lively admits that whether Valero failed to take and pay or just failed to pay the Daily Contract Quantity of gas was critical to their cause of action.

Special Issue Nos. 2 and 3 with the conditional instruction read:

SPECIAL ISSUE NO. 2

> Do you find that Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)?
>
> Answer Special Issue No. 3 only if you answered Special Issue No. 2 "yes," otherwise go to Special Issue No. 4.

SPECIAL ISSUE NO. 3

What sum of money, if any, if paid now in cash, do you find to be due and owing to Lively under the Contract?

Where the court submits the controlling issues raised by the pleadings and the evidence, the case shall not be reversed because of the failure to submit other various phases or different shades of the same issue. TEX. R. CIV. P. 279; *Holmes v. J.C. Penney Co.*, 382 S.W.2d 472, 473 (Tex. 1964). The court here fairly submitted Special Issue No. 2, which was the controlling issue, and properly conditionally submitted Special Issue No. 3, which was the damage issue. The point of error is overruled.

In the last three points of error, Lively contends there is no evidence or insufficient evidence to support the jury's answer to Special Issue No. 2, and that the jury's answer to Special Issue No. 2 was against the great weight and preponderance of the evidence. Lively, after conceding that the evidence of the Gas Market Demand Rule supports the jury finding in Special Issue No. 2, contends it has no probative value as a matter of law because the Gas Market Demand Rule does not abrogate Valero's obligations under the contract. Therefore, Lively would have us ignore this evidence. We disagree.

A no evidence point is a question of law and we can consider only that evidence and the reasonable inference there from which viewed in its most favorable light support the jury finding and we must reject all evidence or reasonable inferences to the contrary. *Glover v. Texas General Indemnity Co.*, 619 S.W.2d 400, 401 (Tex. 1981); *McClure v. Allied Stores of Texas, Inc.*,

608 S.W.2d 901, 904 (Tex. 1980). In determining the sufficiency of the evidence "the court of appeals must consider and weigh all the evidence, and should set aside the verdict only if it is so contrary to the overwhelming weight of the evidence as to be clearly wrong and unjust." *Cain v. Bain,* 709 S.W.2d 175, 176 (Tex. 1986); *Pool v. Ford Motor Co.,* 715 S.W.2d 629 (Tex. 1986). However, we must always remain cognizant that it is for the jury to judge the credibility of the witnesses, to assign the weight to be given their testimony, and to resolve any conflicts or inconsistencies in the evidence. *Town & Country Mobile Homes, Inc. v. Bilyeu,* 694 S.W.2d 651, 656 (Tex. App.—Fort Worth 1985, no writ); *Precision Homes, Inc. v. Cooper,* 671 S.W.2d 924, 929 (Tex. App. —Houston [14th Dist.] 1984, writ ref'd n.r.e.). Therefore, in determining the sufficiency of the evidence, appellate courts must recognize from the verdict of the jury what the jury, in their discretion, chose to believe. In so doing, we must accept the jury's resolution of any conflicts or inconsistencies in the evidence and not attempt to substitute our judgment for theirs. *Pool v. Ford Motor Co.,* 715 S.W.2d at 634.

The record reflects extensive testimony pertaining to the Gas Market Demand Rule and its direct effect upon the "Daily Contract Quantity" and "Deliverability" clauses of the contract. The testimony disclosed essentially that the rule was promulgated by the Texas Railroad Commission, who had regulatory jurisdiction over the critical aspects of the contract, and that Valero purchased from Lively the maximum "Daily Contract Quantity" of gas which was legally "Deliverable" by Lively under the dictates of the Gas Market Demand Rule. Lively attempted to establish that "Deliverability" under the contract was

strictly based on G-10 volumes and that the Gas Market Demand Rule had no application to Valero's obligations under the contract.

The jury verdict clearly reveals that the jury chose to believe Valero's theory and that there was no breach of the "take-or-pay" clause as alleged by Lively. Considering all the evidence under the appropriate standards of review, we cannot conclude that the verdict "is so contrary to the overwhelming weight of the evidence as to be clearly wrong and unjust." *Cain v. Bain*, 709 S.W.2d at 176. The last points of error are overruled.

The judgment of the trial court is affirmed.

SUPREME COURT OF TEXAS
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John T. Adams, Clerk

June 7, 1989

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Mr. Gregory C. King
Bracewell & Patterson
2900 South Tower Pennzoil Place
Houston TX 77002

RE: Case No. C-7676
STYLE: LIVELY EXPLORATION COMPANY ET AL.
v. VALERO TRANSMISSION COMPANY

Dear Counsel:

Today, the Supreme Court of Texas denied the above referenced application for writ of error with the notation, Writ Denied.

Respectfully yours,

John T. Adams, Clerk

By /s/ BLANCA E. MORIN
Deputy

SUPREME COURT OF TEXAS
P. O. Box 12248
Supreme Court Building
Austin, Texas 78711
John T. Adams, Clerk

September 13, 1989

Mr. Jesse P. Luton, Jr.
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Houston TX 77002

RE: Case No. C-7676
STYLE: LIVELY EXPLORATION COMPANY ET AL.
v. VALERO TRANSMISSION COMPANY

Dear Counsel:

Today, the Supreme Court of Texas overruled petitioner's motion for rehearing of the application for writ of error in the above styled case.

Respectfully yours,

John T. Adams, Clerk

By /s/ BLANCA E. MORIN
Deputy

COURT OF APPEALS
FOURTH SUPREME JUDICIAL DISTRICT
OF TEXAS
SAN ANTONIO

JUDGMENT

Appeal No. 04-87-00380-CV

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants

v.

VALERO TRANSMISSION COMPANY,
Appellee

Appeal from the 112th District Court of Sutton County
Trial Court No. 2,930
Honorable Bob Parks, Judge Presiding

JUDGMENT

After hearing this cause and examining the record, the Court finds that the court below committed no reversible error. It is therefore ORDERED that the judgment be AFFIRMED.

It is further ORDERED that Appepllants LIVELY EXPLORATION COMPANY, LEA ROY ALDWELL, INDIVIDUALLY, LEA ROY ALDWELL, WINNIE LEA McPHERSON AND MARJORY REBA JOHANSEN, AS TESTAMENTARY TRUSTEES UNDER THE WILL OF GEORGE L. ALDWELL, DECEASED, JON A. SONNEN, J. HOWARD MARSHALL, ED FARRELL, ELIZABETH STANDISH, THE DESANA COR-

PORATION, JESSEE L. DALLY, CHESTER H. KENLEY, CAROLYN H. JOSEPH, INDEPENDENT EXECUTRIX OF THE ESTATE OF GIFFORD E. JOSEPH, DECEASED, H.B. LIVELY, B. JACKSON BANDY, ROBERT L. BANKS, THEO B. BEAN, WILLIAM R. GIFFORD, CHARLIE GILL, JR., HENRY GUNDERS AND WIFE, ELAINE GUNDERS, KENNETH L. HEWITT, KALLMAN NASHNER, FRANK PACE, JR., MARTIN B. SERETEAN, RAY B. VAUGHTERS AND THEODORE L. WILKINSON, pay all costs of appeal, and the cash deposit filed with the District Clerk in lieu of cost bond be used for and subjected to such costs and this decision be certified to the trial court.

Entered this 31st day of March, 1988.

In the Court of Appeals for the
Fourth Supreme Judicial District of Texas
San Antonio, Texas

APPEAL NO. 04-87-00380-CV

LIVELY EXPLORATION COMPANY, ET AL,
Appellants,

v.

VALERO TRANSMISSION COMPANY,
Appellee.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley, Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H. B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters and Theodore L. Wilkinson, the appellants above-named, hereby appeal to the Supreme Court of the United States from the final judgment of the Court of Appeals for the Fourth Supreme Judicial District of Texas, San Antonio, Texas, affirming the judgment of the trial court, entered in this action on May 18, 1988.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

SCOTT, DOUGLASS & LUTON

By: /s/ JESSE P. LUTON, JR.
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Attorneys for Appellants

CERTIFICATE OF SERVICE

I hereby certify that the above and foregoing Notice of Appeal to the Supreme Court of the United States was served on the appellee by certified mail, return receipt requested, by depositing it in a United States post office or mailbox, with first-class postage prepaid, on the 22nd day of September, 1989, addressed as follows:

J. Clifford Gunter, III
Bracewell & Patterson
2900 South Tower Pennzoil Place
Houston, Texas 77002-2781

/s/ JESSE P. LUTON, JR.
Jesse P. Luton, Jr.

APPEAL NO. 04-87-00380-CV

IN THE COURT OF APPEALS
FOR THE
FOURTH SUPREME JUDICIAL DISTRICT OF TEXAS
SAN ANTONIO, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants,

v.

VALERO TRANSMISSION COMPANY,
Appellee.

Appeal from the District Court of
Sutton County, Texas, 112th Judicial District

APPELLANTS' MOTION FOR REHEARING

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April 12, 1988

APPEAL NO. 04-87-00380-CV

IN THE COURT OF APPEALS
FOR THE
FOURTH SUPREME JUDICIAL DISTRICT OF TEXAS
SAN ANTONIO, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants,

v.

VALERO TRANSMISSION COMPANY,
Appellee.

Appeal from the District Court of
Sutton County, Texas, 112th Judicial District

APPELLANTS' MOTION FOR REHEARING

TO THE COURT OF APPEALS:

Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley, Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H.B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters, and

Theodore L. Wilkinson (collectively referred to as "Lively" or "Appellants") make this motion for a rehearing of the decision of the Court rendered on March 31, 1988, and show:

I.

1. Point of Error: The Court erred in holding that the obligations of Valero under the "take-or-pay" provision of the contract are controlled by the definitions of "Daily Contract Quantity" and "Deliverability" set forth in Article I of the contract.

2. Point of Error: The Court erred in holding that Article XIII, ¶ 13.1 of the contract provides a basis for the application of the Gas Market Demand Rule in determining the obligations of Valero under the "take-or-pay" provision of the contract.

3. Point of Error: The Court erred in holding that the Gas Market Demand Rule was relevant and material towards the issue of the quantity of gas which Lively had available for delivery, or in terms of the contract, Lively's "daily Deliverability of gas."

4. Point of Error: The Court erred in holding that the application of the Gas Market Demand Rule tended to disprove that there was a breach of the "take-or-pay" provision of the contract.

5. Point of Error: The Court erred in holding that Lively does not contend that the application of the Gas Market Demand Rule to Lively and Valero in the charge was erroneous.

6. Point of Error: The Court erred in holding that the Gas Market Demand Rule was relevant and

material to prove or disprove that there was a breach of the "take-or-pay" provision of the contract as alleged by Lively.

7. Point of Error: The Court erred in holding that the inclusion of the Gas Market Demand Rule in the charge was not harmful error.

8. Point of Error: The Court erred in overruling Appellants' Points of Error One and Two.

Argument and Authorities

These points of Error 1 - 8 will be argued together, since all of them relate to the application of the Texas Gas Market Demand Rule to the obligations of Valero to take or pay for gas under the contract between Lively and Valero which is the subject of this appeal.

The Court's opinion bases its rulings involved in the above points of error and its application of the Gas Market Demand Rule to the obligations of Valero under the "take-or-pay" provision of the contract on (1) the general definitions of "Daily Contract Quantity" and "Deliverability" as set forth in Article I of the contract and (2) the clause in Article XIII, ¶ 13.1 making the contract "subject to all valid applicable federal and state laws or city ordinances, and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction."

By giving controlling effect to the general definitions of "Daily Contract Quantity" and "Deliverability" in Article I and the general regulatory clause in Article XIII, ¶ 13.1, the Court ignores, gives no effect to, and writes out of the contract the "take-or-pay" provision in

Article V, ¶ 5.3 of the contract. That portion of the contract, which is the *only* part of the contract dealing with Valero's "take-or-pay" obligations, expressly states what "Daily Contract Quantity" shall mean for "take-or-pay" purposes and how "Sellers' Deliverability shall be determined" for "take-or-pay" purposes under the contract. It states that for "take-or-pay" purposes "Daily Contract Quantity" shall be "equal to ninety percent (90%) of Sellers' daily Deliverability of gas hereunder." It then states that "Sellers' Deliverability *shall be determined and established by Buyer by testing the actual ability of Sellers' wells to deliver into Buyer's facilities at the point of delivery.*"*

It is Appellants' position that the trial court and this Court should have held as a matter of law that this "take-or-pay" provision is complete in itself and binding upon the parties to the contract and that Valero has an obligation to pay for the minimum quantity of gas expressly provided for therein if not taken by Valero for any reason, including the Gas Market Demand Rule. The error committed by the trial court and this Court was in permitting that clear and unambiguous prov[illegible] of the contract to be construed by the jury and including in the instructions to the jury with respect to that issue definitions and other matters pertaining to the Gas Market Demand Rule and Railroad Commission regulatory authority. The trial court's actions caused the jury to believe that it could only answer Special Issue 2 "No" and that to do otherwise would violate the law.

Other courts, and even the Railroad Commission itself, have recognized that the Gas Market Demand Rule does

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* Emphasis added throughout.

not affect contractual rights and obligations between parties such as "take-or-pay" provisions. The most recent Texas appellate decision recognizing this involved Valero. *Valero Transmission Co. v. Mitchell Energy Corp.*, 743 S.W.2d 658 (Tex. App.—Houston [1st Dist.] 1987, no writ). The contract there, like the one here, contained "minimum purchase and take requirements," a force majeure clause, and a provision comparable to Article XIII, ¶ 13.1 in this contract. *Id.* at 660. There, as here, Valero failed to take the minimum quantities of gas required by the contract and sought to defend its breach of the contract by relying on the Gas Market Demand Rule. Valero's attorneys there, who also are Valero's attorneys in this case, argued there, as they did here, that Valero "has taken gas under the contract in accordance with its market demand and that any contractual requirement that it purchase additional amounts would constitute a violation of Texas law." *Id.* at 661. Valero's attorneys also argued there, as they did here, that "there was no market demand for the gas" because the contract price was too high in relation to the market, that the gas would have to be sold by Valero at a price of over $4 per unit, and that "there is no existing market for $4 gas." *Id.* They argued, as they did in this case, "that any contractual requirement that it [Valero] take and pay for gas in excess of its market demand violates the law." *Id.*

The Houston Court of Appeals flatly rejected Valero's arguments on the grounds that (1) "the Railroad Commission has no authority to abrogate contract rights," (2) the Railroad Commission's rules do not "purport to affect contract rights," (3) "Valero has not proven that complying with the contract would violate the

law," and (4) the force majeure clause did not relieve Valero of the obligation to perform under the contract because "a sudden or significant change in price, or the fact that one of the parties may gain or lose during a particular period of the contract, is not sufficient to constitute an extraordinary, unforeseeable event that would excuse performance under the force majeure clause." *Id.* at 662-664. Citing this Court's opinion in *Alamo Clay Products, Inc. v. Gunn Tile Co.*, 597 S.W.2d 388 (Tex. Civ. App.—San Antonio 1980, writ ref'd n.r.e.), the Court stated:

> An economic downturn in the market for a product is not such an unforeseeable occurrence that would justify application of the force majeure provision, and a contractual obligation cannot be avoided simply because performance has become more economically burdensome than a party anticipated. *Id.* at 663.

Lively here seeks only what Mitchell Energy sought there—to require Valero to comply with its contractual obligations. However, here Lively is not seeking to require Valero to take *and* pay for a minimum quantity of gas as required in the "take-or-pay" provision of the contract. Valero's alternative *pay* obligation in this contract clearly is not violative of any law or the Gas Market Demand Rule, because it does not require production but payment in lieu of production. *Resources Investment Corp. v. Enron Corp.*, 669 F.Supp. 1038, 1041 (D. Colo. 1987); *Kaiser-Francis Oil Co. v. Producers' Gas Co.*, No. 83-C-400-B (N.D. Okla. June 19, 1985) (Appendix to Brief for Appellants at A42); *International Minerals & Chemical Corp. v. Llano, Inc.*, 770 F.2d 879 (10th Cir. 1985).

This Court's opinion ignores, gives no effect to, and writes out of the contract the "take-or-pay" provision in Article V, ¶ 5.3. This is a key provision of the contract, as Mr. Lively testified that he would not have executed the contract if that provision had not been included (S.F. 121). In ignoring the "take-or-pay" provision of the contract, this Court has violated long-established rules of construction as follows:

(1) parties to an instrument intend every clause to have some effect and purpose and in some measure to evidence their agreement, and this purpose should not be thwarted — *Woods v. Sims*, 154 Tex. 59, 273 S.W.2d 617, 620 (1954); *Pinehurst v. Spooner Addition Water Co.*, 432 S.W.2d 515 (Tex. 1968); *Reynolds v. McCullough*, 739 S.W.2d 424, 428 (Tex. App.— San Antonio 1987, no writ); Restatement of the Law of Contracts § 230 (1932);

(2) a contract should be construed in a manner which gives effect to all of its provisions — *Coker v. Coker*, 650 S.W.2d 391 (Tex. 1983); *Universal C.I.T. Corp. v. Daniel*, 150 Tex. 513, 243 S.W. 2d 154 (1951); *Sun Oil Co. v. Burns*, 125 Tex. 549, 84 S.W.2d 442 (1935); *Williams v. J & C Royalty Co.*, 254 S.W.2d 178 (Tex. Civ. App.— San Antonio 1952, writ ref'd);

(3) courts should avoid the adoption of a construction of a contract which would render meaningless any provision of that contract—*LaGuarta, Gavrel & Kirk, Inc.*, 596 S.W.2d 517 (Tex. 1980); *Mattison, Inc. v. W.F. Larson, Inc.*, 529

S.W.2d 271 (Tex. Civ. App.—Amarillo 1975, writ ref'd n.r.e.); and

(4) if clauses in a contract are in apparent conflict, they should be reconciled by a reasonable interpretation, "that is, such a construction as will make the agreement fair, customary, and such as prudent businessmen would naturally execute"—*Stone v. Robinson*, 180 S.W. 135, 136 (Tex. Civ. App.—Amarillo 1915, writ ref'd).

This court has adopted a construction of the contract in the light of a rule that was adopted by the Railroad Commission several years *after* the contract was entered into. The Court bases its action in part upon a general regulatory clause (Article XIII, ¶ 13.1) that appears in every natural gas contract. The Court's holding in that respect would eliminate "take-or-pay" liability under all natural gas contracts. The Court's opinion renders meaningless and gives no effect to the "take-or-pay" provision of the contract. It places a legal stamp of approval on Valero's manipulation of its nominations and takes of gas under the contract in a manner that was clearly never intended by the parties and completely relieves Valero of any liability under the "take-or-pay" provision of the contract.

No other court has ever held that the "take-or-pay" provision in a natural gas contract is not to be given effect because of the Texas Gas Market Demand Rule. This Court's holding not only is contrary to the clear and unambiguous language of the "take-or-pay" provision of the contract but also is a direct contradiction of the history of the Texas Gas Market Demand Rule

and the Railroad Commission's stated intent that the Gas Market Demand Rule "shall not affect existing contractual rights and obligations between parties." (12 Tex. Reg. 536 (1987); Brief for Appellants at 12-14.) Further, this Court's action nullifies a provision that has been recognized as a standard provision in gas contracts for over thirty years and has been upheld by the courts consistently as being conscionable and fair and as properly apportioning the risks between the buyer and seller of gas. 4 H. Williams & C. Meyers, Oil & Gas Law § 724.5 (1983); *Universal Resources Corp. v. Panhandle Eastern Pipeline Co.*, 813 F.2d 77 (5th Cir. 1987).

II.

9. Point of Error: The Court erred in holding that the trial court properly submitted to the jury Special Issue No. 2 and Instruction No. 2 containing the definition of the term "Deliverability" from Article I(j) of the contract.

10. Point of Error: The Court erred in holding that Lively waived their objection to Special Issue No. 2 and Instruction No. 2 containing the definition of "Deliverability" from Article I(j) of the contract.

11. The Court erred in holding that the instructions to Special Issue No. 2 were relevant, were not a comment on the weight of the evidence, and did not cause the rendition of an improper judgment.

12. The Court erred in holding that considering the entire set of instructions to Special Issue No. 2 and the entire charge, the instruction contained in the third paragraph of the instruction to Special Issue

No. 2 was not a comment on the weight of the evidence and probably did not cause the rendition of an improper judgment.

13. The Court erred in overruling Appellants' Points of Error Three, Four, and Five.

Argument and Authorities

These points of error will be argued together, as they all relate to the trial court's submission of, and this Court's opinion with respect to, Special Issue No. 2 and Instruction No. 2 to the extent not discussed under I above.

Plaintiff made extensive objections to Special Issue No. 2 and Instruction No. 2 in the trial court. Those objections were: (1) the issue should not be submitted because it was not a controlling issue and its submission deprived plaintiff of the unconditional submission of the controlling Special Issue No. 3; (2) the inclusion of the language of Article V, ¶ 5.2 of the contract in Instruction No. 2 was an error because there had been no evidence presented to warrant its submission and it could serve only to mislead and confuse the jury by leading the jury to believe that it relates to Valero's minimum take under the contract and possibly lead to an erroneous verdict on Special Issue No. 2 and possibly also on Special Issue No. 3; (3) the part of the instruction pertaining to waste was error because there was no evidence to warrant the submission of these instructions pertaining to waste and they could only mislead and confuse the jury and possibly result in an erroneous verdict; (4) these instructions were meaningless abstract statements of the law without reference

to or connection with any evidence or issue in this case; (5) the instruction with respect to Valero's obligation under the Gas Market Demand Rule was an error because there was no evidence in the trial of the case that the Gas Market Demand Rule has affected any issue being presented to the jury for determination; (6) the Gas Market Demand Rule should have no bearing on the determination of the issue the jury was being asked to answer, and its inclusion in any form in the instruction could serve only to mislead and confuse the jury and possibly result in an erroneous verdict; (7) the instructions concerning the Gas Market Demand Rule are meaningless abstract statements of law without any reference to or connection with any issue in this case; and (8) there was no evidence that compliance with the Gas Market Demand Rule in any way affected Valero's ability to perform its obligations under the contract and particularly its pay obligation under the "take-or-pay" clause (S.F. 1675-1681).

Just as the Court felt it was necessary to look at the entire Instruction No. 2 to determine whether it or any part thereof had an adverse effect on the jury, the Court should consider Plaintiffs' entire objections to Special Issue No. 2 and Instruction No. 2 to determine their sufficiency on the question of waiver. Appellants respectfully submit that when viewed in their entirety the extensive objections were sufficient and that there was no waiver that would preclude the consideration by this Court of the points of error contained in the Brief for Appellants and this motion.

The fundamental error was in the trial court's submission of Special Issue No. 2 and Instruction No. 2.

That issue and instruction should not have been submitted for the reasons objected to by Appellants in the trial court. The trial court's submission totally confused and mislead the jury by causing them to believe that Valero was not required to take or pay for more gas under the contract than its market demand and that if the jury answered Special Issue No. 2 "Yes" it would itself be causing a violation of the law. Therefore, Special Issue No. 2 and Instruction No. 2, with all of their implications, ramifications, and meanings, confused and mislead the jury and resulted in an erroneous verdict and judgment.

The trial court's submission of Special Issue No. 2 and Instruction No. 2 tainted the entire submission to the jury. The erroneous and superfluous instructions to the jury concerning the Gas Market Demand Rule, waste, ratable take, maximum rate of flow permitted by the Railroad Commission, and information to be supplied the Railroad Commission (1) confused and misled the jury by causing them to believe that because of the Gas Market Demand Rule there could be no liability of Valero to Lively under the contract; (2) constituted an impermissible comment that tilted or nudged the jury in favor of Valero, in violation of the Supreme Court's holding in *Lemos v. Montez*, 680 S.W.2d 798, 801 (Tex. 1984); and (3) improperly shifted to the jury the determination of a question of law as to the applicability and effect, if any, of the Gas Market Demand Rule on the "take-or-pay" obligation of Valero under the contract.

"It is fundamental that only issues of fact should be submitted to the jury," and an instruction which shifts

to the jury the determination of a legal issue that should have been determined by the trial court is improper and requires reversal. *See Knutson v. Ripson,* 346 S.W.2d 424, 426 (Tex. Civ. App.—Amarillo 1961), aff'd 163 Tex. 312, 354 S.W.2d 575 (1962); *Foerster v. Peoples,* 362 S.W.2d 918 (Tex. Civ. App.—Amarillo 1962, no writ); *Barton v. Davis,* 441 S.W.2d 299, 301 (Tex. Civ. App.—El Paso 1969, writ ref'd n.r.e.); *Emmord's Inc. v. Obermiller,* 526 S.W.2d 562, 566 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.).

As discussed in I above, as a matter of law the Gas Market Demand Rule does not affect private contract rights. The trial court's failure to so hold, its further action in submitting this legal question to the jury for determination, and its action in confusing and misleading the jury by the contents of, and the undue emphasis of matters in, Instruction No. 2 resulted in the rendition of an improper judgment, which should be set aside.

III.

15. Point of Error: The Court erred in holding that the trial court fairly submitted Special Issue No. 2, which was the controlling issue, and properly conditionally submitted Special Issue No. 3, which was the damage issue.

16. Point of Error: The Court erred in overruling Appellants' Point of Error Six.

Argument and Authorities

As heretofore discussed, the submission of Special Issue No. 2 and Instruction No. 2 was improper for various reasons and confused and misled the jury. As a result of

the jury's answer to Special Issue No. 2, the jury was never given the opportunity to determine whether any money was owing to Lively by Valero under the "take-or-pay" provision of the contract. That was the ultimate and controlling issue to be determined by the jury with respect to Valero's take-or-pay liability.

The trial court should not have submitted Special Issue No. 2 but should have submitted only Special Issue No. 3:

> What sum of money, if any, if paid now in cash, do you find to be due and owing under the Contract?

The submission of that ultimate and controlling issue would have permitted the jury to consider in deciding that issue all proper evidentiary issues and matters, including whether Valero had failed to take or pay for the Daily Contract Quantity under the contract. The trial court's conditional submission of the ultimate and controlling issue in the case, predicated on a response to an evidentiary issue which should not have been submitted, deprived Lively of its right to have the ultimate and controlling issue with respect to one of its grounds for recovery determined by the jury. *Blanton v. E. & L Transport Co.*, 146 Tex. 377, 207 S.W.2d 368 (1948); *Montgomery v. Gay*, 212 S.W.2d 941 (Tex. Civ. App.—Fort Worth 1948, no writ); 3 R. McDonald, Texas Civil Practice in District and County Courts §§ 12.16.1 and 12.16.2(b) (rev. 1983).

In effect, Lively's entire take-or-pay cause of action was conditionally submitted. The conditional submission of Special Issue No. 3 was extremely prejudicial to Lively, constituted harmful error, and led to the rendition of an improper judgment.

IV.

17. Point of Error: The Court erred in holding that Lively conceded that the evidence of the Gas Market Demand Rule supports the jury finding in Special Issue No. 2.

18. Point of Error: The Court erred in holding that there was evidence to support the jury's finding on take-or-pay liability.

19. Point of Error: The Court erred in holding that legally incorrect evidence can be relied upon to support the jury's finding on take-or-pay liability.

20. Point of Error: The Court erred in not holding that the jury's finding on take-or-pay liability was against the great weight and preponderance of the evidence.

21. Point of Error: The Court erred in overruling Appellants' Points of Error Seven, Eight, and Nine.

22. Point of Error: The Court erred in affirming the judgment of the trial court.

Argument and Authorities

These points of error will be argued together, as they all involve the consideration of the evidence with respect to the central issue in this case—Valero's take-or-pay liability.

The evidence presented by both parties in the trial court conclusively established that Valero failed to take or pay for a quantity of gas equal to the Daily Contract Quantity. Under the clear and unambiguous terms of the contract, the Daily Contract Quantity "was equal to ninety percent (90%) of Seller's daily Deliverability hereunder,"

and "Sellers Deliverability shall be determined and established by Buyer by testing the actual ability of Sellers' wells to deliver into Buyer's facilities at the points of delivery." (Article V, ¶ 5.3).

The only evidence presented to show that Valero failed to take or pay for the Daily Contract Quantity was based entirely on Valero's invalid argument that as a result of the Gas Market Demand Rule Valero had no liability under the "take-or-pay" provision of the contract (S.F. 1449). However, Valero itself recognized that there is nothing in the Gas Market Demand Rule that prevents Valero from paying for a deficiency when a deficiency exists by operation of the "take-or-pay" provision (S.F. 840).

Contrary to the Court's statement, Lively did not concede "that the evidence of the Gas Market Demand Rule supports the jury finding in Special Issue No. 2." Instead, it was and is Lively's position that there was no evidence to support that finding and that the Gas Market Demand Rule has no legal effect upon Valero's obligation to *pay* Lively for the minimum quantity it was obligated to take or pay for under the contract. That is an alternative obligation which is not affected or excused by the Gas Market Demand Rule.

Valero's position with respect to the Gas Market Demand Rule is incorrect as a matter of law because (1) it is contrary to the clear and unambiguous language in the "take-or-pay" provision of the contract and (2) it is based upon the contention that the Gas Market Demand Rule abrogates Valero's obligations under the contract to take or pay for a minimum quantity of gas each Contract Year. When, as here, the Court is barred by rules

of law from giving weight to the only evidence offered to prove a vital fact, a "no evidence" point of error must be sustained. *Royal Indemnity Co. v. Little Joe's Catfish Inn, Inc.*, 636 S.W.2d 530, 531 (Tex. App.—San Antonio 1982, no writ); R. Calvert, *"No Evidence" and "Insufficient Evidence" Points of Error*, 38 Tex. L. Rev. 361, 363-365 (1960).

V.

23. Point of Error: The Court's action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid because the Texas Gas Market Demand Rule as applied by the Court is pre-empted by the Natural Gas Policy Act.

24. Point of Error: The Court's action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid because the Texas Gas Market Demand Rule as applied by the Court violates the Commerce Clause of the United States Constitution.

Argument and Authorities

The Court's action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid because the Texas Gas Market Demand Rule as applied by the Court is pre-empted by the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301 *et seq.*, and violates the Commerce Clause of the United States Constitution, U.S. Const. art. I, § 8, cl. 3.

In 1978, Congress passed the NGPA, which "has been justly described as 'a comprehensive statute to govern future natural gas regulation.' " *Public Service Commission of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983). As stated by the United States Supreme Court in *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409 (1986) ("*Transco*"):

> [T]he NGPA reflects a congressional belief that a new system of natural gas pricing was needed to balance supply and demand. See S Rep No. 95-436, at 10. The new federal role is to "overse[e] a *national market price regulatory scheme.*" Haase, 16 Houston L Rev, at 1079; see S Rep No. 95-436, at 21 (NGPA implements "a new commodity value pricing approach"). The NGPA therefore does not constitute a federal retreat from a comprehensive gas policy. Indeed, *The NGPA in some respects expanded federal control, since it granted FERC jurisdiction over the intrastate market for the first time.* See the Act's §§ 311 and 312, 15 USC §§ 3371 and 3372 [15 USCS §§ 3371 and 3372].

In *Transco*, the Supreme Court held that a ratable take order requiring gas purchasers to purchase gas without discrimination in favor of one producer against another in the same source of supply is pre-empted by the Natural Gas Act and the NGPA. In view of that holding, the Court stated that "we need not reach the question of whether, absent federal occupation of the field, Mississippi's action would nevertheless run afoul of the Commerce Clause." *Id.* at 425. The Court said that "Mississippi's action directly undermines Congress' determination that the supply, the demand and the price of high-cost

gas be determined by market forces." *Id.* at 422. The Court stated further:

> In light of the *NGPA's unification of the interstate and intrastate markets,* the contention that Congress meant to permit the States to impose inconsistent regulations is especially unavailing. Second, Mississippi's order would have the effect of increasing the ultimate price to consumers. *Take-or-pay provisions are standard industrywide.* See Pierce, 68 Va L Rev, at 77-78; H R Rep No. 98-814, pp 23-25, 133-134 (1984). *Pipelines are already committed to purchase gas in excess of market demand.* Mississippi's rule will require Transco to take delivery of noncontract gas; this will lead Transco not to take delivery of contract gas elsewhere, *thus triggering take-or-pay provisions.*

Id. at 423. The Court thus recognized the validity of take-or-pay provisions of gas contracts where pipelines are committed to purchase gas in excess of market demand.

Following the Supreme Court's holding in *Transco,* the United States District Court, Southern District of Texas, Houston Division, in *McGoldrick Oil Company, et al v. United Gas Pipe Line Company,* Civil Action No. H-84-4971, by order of September 17, 1987, a copy of which is attached hereto as Appendix A, held:

> The Texas Gas Market Demand Rule, governing ratable production, is preempted under *Trans-continental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi,* ___U.S.___, 106 S. Ct. 709 (1986). Although states may regulate the production of natural resources in order to achieve a statewide public benefit, such as conservation, *the Texas*

> *rule is relied on by United solely to free itself of a contractual obligation. If the rule were enforced to free pipelines of their obligations under take-or-pay contracts, its effect would be contrary to the public interest sought to be served by the federal regulation: gas prices would remain high in spite of an oversupply.*

In a Memorandum on Denial of Modification of the above order, a copy of which is attached hereto as Appendix B, that Court stated as follows:

> United Gas Pipe Line's motion to modify the order of September 17, 1987, will be denied. The September order modified an earlier June memorandum, making it consistent with Transcontinental Gas Pipe Line Corporation v. State Oil and Gas Board of Mississippi, ____U.S.____, 106 S. Ct. 709 (1986).
>
> Had United wanted to limit its takes of gas under its contract with McGoldrick during periods when gas was in surplus supply, it could have negotiated a market out clause. The contract was drafted by sophisticated attorneys for clients with substantial experience in gas production and marketing. *Allegations that United in good faith believed that the contract's incorporation of the Texas Gas Market Demand Rule was to work as a substitute for a market out clause which could be invoked when the price and demand for gas dropped are disingenuous. United* signed a contract for mandatory minimum purchases of gas during a time of inflated gas prices, gambling that the economy would remain favorable to suppliers. Even if United lacked the capacity immediately to take and resell McGoldrick's gas, it was not commercially impracticable for United to pay for the gas, as it was contractually obligated to do.

> The court's September order did not invalidate the Texas ratable production scheme. As Transco has instructed, the statute remains enforceable to achieve certain state goals such as preservation of resources, protection of correlative rights, and waste prevention. Congress' intent to move toward a less-regulated national gas market cannot be interpreted as an invitation to the states to impose additional regulations. Transco at 717. *The Texas Gas Market Demand Rule, as applied to purchasers such as United, is preempted.* 106 S. Ct. at 718.

In *ANR Pipeline Co. v. Corporation Commission of Oklahoma*, 643 F.Supp. 419 (W.D. Okla. 1986), the Court held the Oklahoma statute and the Oklahoma Corporation Commission Rule 1-305 to be *"unconstitutional as applied to the plaintiffs"* in that case. *Id.* at 424. That statute and rule, like the Texas Gas Market Demand Rule, provided for ratable purchases of gas by pipelines from a common source of supply on a system-wide basis and established a priority schedule for the purchase of gas when production exceeded that purchaser's market demand.

In *Schneidelwind v. ANR Pipeline Co.*, 56 U.S.L.W. 4249 (U.S. March 22, 1988), the United States Supreme Court held that a Michigan statute "regulates in a field the NGA has occupied to the exclusion of state law, and that it is therefore preempted." *Id.* at 4251. The statute required a public utility exercising or claiming the right to transport natural gas for public use to obtain approval from the Michigan Public Service Commission before issuing long term securities. Referring to the "comprehensive scheme of federal regulation" in the Natural Gas Act, the Court stated that "while the NGA

does not expressly grant FERC preissuance authority over the securities of natural gas companies, FERC achieves the regulatory ends of such review with regard to rates and facilities through the exercise of its express regulatory responsibilities." *Id.* at 4254. In view of its conclusion that the Michigan statute "is pre-empted by the NGA," the Court stated that "we need not decide whether, absent federal occupation of the field, Act 144 violates the Commerce Clause. See Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Bd. of Mississippi, 474 U.S. 409, 425, (1986)." *Id.* at 4254.

While these cases involved interstate pipelines, no valid reason exists for distinguishing between interstate and intrastate pipelines insofar as the holdings of these cases are concerned. As recognized in *Transco*, the NGPA resulted in "unification of the interstate and intrastate markets," and now there is a "national natural gas market." 474 U.S. at 423-424. That this is the case is further evidenced by the fact that Section 105 of the NGPA covers "sales under existing *intrastate* contracts."

The authority given by the NGPA to FERC to regulate the price of "all first sales of natural gas irrespective of its interstate or intrastate character" was upheld in *State of Oklahoma v. Federal Energy Regulatory Commission*, 661 F.2d 832 (10th Cir. 1981), *cert. denied*, 457 U.S. 1105 (1982). The Court there held that "the enactment of the NGPA is a constitutionally acceptable exercise of Congress' Commerce Clause power." 661 F.2d at 838. The basis of the Court's holding, among other things, was that Congress may regulate wholly intrastate activities which have "a substantial economic effect on interstate commerce or when the intrastate activity is necessary to effectuate the interstate regula-

tion"; "Congress had a rational basis for determining that the unregulated intrastate market imposed a burden on interstate commerce"; and "Congress may pre-empt state conservation regulations which interfere with or burden interstate commerce." *Id.* at 834-835.

In considering the validity of state ratable take rules such as the Texas Gas Market Demand Rule, there is no longer any valid reason for differentiating between interstate and intrastate pipelines. Both pipelines purchase from the same producers, the same fields, and even the same wells, and the maximum price of the first sales to them is regulated by FERC irrespective of the destination of the gas. Therefore, the Texas Gas Market Demand Rule as applied by this Court is not only pre-empted by the NGPA but also runs afoul of and violates the Commerce Clause of the United States Constitution.

Even if, as Valero contends, the definition of "Deliverability" in Article I(j) of the contract can be construed as limiting Valero's takes of gas to its market demand under the Texas Gas Market Demand Rule, that portion of the agreement would be unenforceable here since during the Contract Years in question the Gas Market Demand Rule as so applied is pre-empted by the NGPA and violates the Commerce Clause. "Parties, by contract, cannot impair the validity of a law, nor control or limit the provisions of statute." *McFarland v. Haby*, 589 S.W. 2d 521, 524 (Tex. Civ. App.—Austin 1979, writ ref'd n.r.e.); *Gorman v. Gause*, 565 S.W.2d 855 (Tex. Comm'n App. 1933, judgmt adopted).

For all of the reasons set forth herein, Appellants respectfully submit that this Court erred in affirming the judgment of the trial court.

WHEREFORE, Appellants request that Appellants' motion for rehearing be granted and that Appellants have the relief prayed for in the Prayer for Relief set forth in the Brief for Appellants filed herein.

Respectfully submitted,

SCOTT, DOUGLASS & LUTON

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CERTIFICATE OF SERVICE

I hereby certify that the above and foregoing Appellants' Motion for Rehearing was served on the Appellee or its attorney by delivery of a true copy by certified mail, return receipt requested, by depositing it, postpaid, in an official depository under the care and custody of the United States Postal Service on the 12th day of April, 1988, enclosed in a wrapper addressed as follows:

J. Clifford Gunter, III
Carrin F. Patman
Laura B. Herring
Gregory B. King
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Houston, Texas 77002

/s/ JESSE P. LUTON, JR.
Jesse P. Luton, Jr.

APPENDIX A

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CIVIL ACTION NO. H-84-4971

McGOLDRICK OIL COMPANY, et al.,
Plaintiffs,

v.

UNITED GAS PIPE LINE COMPANY,
Defendant.

ORDER

McGoldrick's motion for reconsideration is denied in part and granted in part.

1. The Texas Gas Market Demand Rule, governing ratable production, is preempted under *Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi*, ____U.S.____, 106 S. Ct. 709 (1986). Although states may regulate the production of natural resources in order to achieve a state-wide public benefit, such as conservation, the Texas rule is relied on by United solely to free itself of a contractual obligation. If the rule were enforced to free pipelines of their obligations under take-or-pay contracts, its effect would be contrary to the public interest sought to be served by the federal regulation: gas prices would remain high in spite of an oversupply.

The Texas ratable production rule conflicts with the Natural Gas Policy Act objective of securing fair prices

for consumers. Just as Mississippi's action in *Transco* undermined Congress's determination that the supply, the demand, and the price of high-cost gas be determined by market forces, the Texas regulation could have the identical effect of distorting the market by decreasing the supply of gas.

2. United's affirmative defenses of physical and legal impossibility, commercial impracticability, lack of mutual assent, mistake, and penalty are not viable. Performance has not been made impossible, just unprofitable.

> Substantial frustration and commercial impracticality have not excused performance under take-or-pay clauses where the parties are knowledgeable bargaining entities. The negotiating parties are expected to have an awareness of market conditions as changeable rather than stable an the experience with regulatory agencies so that prospective regulation is assumed.

Forest Oil Corp. v. El Paso Natural Gas Co., No. 86-1948-W (W.D. Okla., May 6, 1987). *Challenger Minerals, Inc. v. Southern Natural Gas Co.*, No. 84-C-357-E (N.D. Okla., Sept. 9, 1986); *Forest Oil Corp. v. El Paso Natural Gas Co.*, No. 86-1948-W (W.D. Okla., May 6, 1987); *Northern Indiana Pub. Serv. Carbon County Coal*, 799 F.2d 265 (7th Cir. 1986); *Coquina Oil Corporation v. Transwestern Pipeline Company*, No. 86-562-M (D. N.M., Sept. 19, 1986); *Universal Res. Corp. v. Panhandle E. Pipe Line Co.*, 813 F.2d 77 (5th Cir. 1987).

3. McGoldrick's antitrust claims in Counts I and II of the amended complaint allege the same facts and a violation of the same statute; the only difference is the nature

of the alleged injury. Because summary judgment was based on a finding that there was no refusal to deal, both claims fail.

4. McGoldrick's motion for a judgment under Rule 54(b) is granted.

Signed on September 17, 1987, at Houston, Texas.

By: /s/ LYNN N. HUGHES
Lynn N. Hughes
United States District Judge

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CIVIL ACTION NO. H-84-4971

McGOLDRICK OIL COMPANY, et al.,
Plaintiffs,

v.

UNITED GAS PIPE LINE COMPANY,
Defendant,

MEMORANDUM ON DENIAL OF MODIFICATION

United Gas Pipe Line's motion to modify the order of September 17, 1987, will be denied. The September order modified an earlier June Memorandum, making it consistent with *Transcontinental Gas Pipe Line Corporation v. State Oil and Gas Board of Mississippi*, ____U.S.____, 106 S. Ct. 709 (1986).

Had United wanted to limit its takes of gas under its contract with McGoldrick during periods when gas was in surplus supply, it could have negotiated a market out clause. The contract was drafted by sophisticated attorneys for clients with substantial experience in gas production and marketing. Allegations that United in good faith believed that the contract's incorporation of the Texas Gas Market Demand Rule was to work as a substitute for a market out clause which could be invoked when the price and demand for gas dropped are disingenuous.

United signed a contract for mandatory minimum purchases of gas during a time of inflated gas prices, gambling that the economy would remain favorable to suppliers. Even if United lacked the capacity immediately to take and resell McGoldrick's gas, it was not commercially impracticable for United to pay for the gas, as it was contractually obligated to do. The court's September order did not invalidate the Texas ratable production scheme. As Transco has instructed, the statute remains enforceable to achieve certain state goals such as preservation of resources, protection of correlative rights, and waste prevention. Congress' intent to move toward a less-regulated national gas market cannot be interpreted as an invitation to the states to impose additional regulations. Transco at 717. The Texas Gas Market Demand Rule, as applied to purchasers such as United, is preempted. 106 S. Ct. at 718.

United's claim that by compelling it to pay for gas which it cannot take, the cost of gas to consumers will go up, is at odds with simple economics; when a commodity is in abundant supply, absent artificial controls, it can be purchased by consumers at a lower price. Higher consumer prices may ultimately occur when the oil industry revives and suppliers pass on to their customers the costs of their unfavorable contracts with producers. This effect may not, however, be invoked to vitiate an arms length, long-term supply contract; indeed, no supply contract would survive a price change. Every error of judgment in supply contracts raises the cost of the commodity to customers.

Signed on December 9th, 1987, at Houston, Texas.

By: /s/ LYNN N. HUGHES
Lynn N. Hughes
United States District Judge

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NO. C-7676

IN THE
SUPREME COURT OF TEXAS
AUSTIN, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Petitioners

v.

VALERO TRANSMISSION COMPANY,
Respondent.

PETITIONERS' APPLICATION FOR WRIT OF ERROR

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June 15, 1988

COMPLETE LIST OF THE PARTIES

Pursuant to Rule 131(a) of the Texas Rules of Appellate Procedure, a complete list of the names of all parties follows:

Petitioners: Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley, Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H. B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters, and Theodore L. Wilkinson.

Respondent: Valero Transmission Company.

NO. C-7676

IN THE
SUPREME COURT OF TEXAS
AUSTIN, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Petitioners,

v.

VALERO TRANSMISSION COMPANY,
Respondent.

PETITIONERS' APPLICATION FOR WRIT OF ERROR

To The Supreme Court of Texas:

Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley, Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H. B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters, and Theodore L. Wilkinson (collectively referred to as

"Lively" or "Petitioners"), Appellants in Cause No. 04-87-00380-CV in the Court of Appeals for the Fourth Supreme Judicial District of Texas, San Antonio, Texas (plaintiffs in the district court), respectfully submit their application for writ of error to correct errors of law committed by the Court of Appeals in affirming the judgment for Respondent, Valero Transmission Company ("Valero" or "Respondent"), Appellee below (defendant in the district court).

STATEMENT OF THE CASE

This is a case in which Lively, a gas producer-seller, sued for recovery of damages from Valero, an intrastate gas pipeline-purchaser, for breach of the take-or-pay provision and the pricing provision of a gas purchase contract. The case was tried before a jury, and on the basis of the jury's answers to the special issues the Trial Court entered judgment that Lively take nothing on their claim for breach of the take-or-pay provision of the contract, awarding Lively $1,204,778.60 on the pricing claim and $500,000.00 for attorneys' fees. Lively appealed that part of the Trial Court's judgment ordering that they take nothing on their claim for breach of the take-or-pay provision of the contract.

The opinion of the Court of Appeals on Appellants' motion for rehearing,[1] Lively Exploration Company, et al. v. Valero Transmission Company, ____S.W.2d____ (Tex. App.—San Antonio 1988), correctly states the nature and result of the case.

---

1. The Court of Appeals denied Appellants' motion for rehearing deleting only one sentence in the original opinion which had no effect on the Court's ruling. Therefore, Appellants did not, and were not required to, file a second motion for rehearing under Tex. R. App. P. 100(d).

STATEMENT OF JURISDICTION

The Supreme Court has jurisdiction of this case under TEX. GOV'T CODE ANN. § 22.001(a)(6) (Vernon 1988).

POINTS OF ERROR

POINT 1. The Court of Appeals erred in holding that the Texas Gas Market Demand Rule applies in determining the obligations of Valero under the take-or-pay provision of the contract.

POINT 2. The Court of Appeals erred in holding that the Texas Gas Market Demand Rule was relevant and material to prove or disprove that there was a breach of the "take-or-pay" provision of the contract as alleged by Lively.

[Points 1 and 2 are germane to: Plaintiffs' Original Petition (Tr. 3-7); Plaintiffs' Second Amended Original Petition (Tr. 35-40); Defendant's Fourth Amended Original Answer, ¶ 11-14 (Tr. 48-50); Judgment (Tr. 118-211); Points of Error 1-6, Appellants' Motion for Rehearing.]

POINT 3. The Court of Appeals erred in holding that the inclusion of the Texas Gas Market Demand Rule in the charge to the jury was not harmful error.

[Germane to: Special Issue No. 2 (Tr. 145-146); Plaintiffs' Motion for Judgment and for Partial New Trial, ¶ 7 (Tr. 160-163); Point of Error 7, Appellants' Motion for Rehearing.]

POINT 4. The Court of Appeals erred in holding that the obligations of Valero under the take-or-pay provision of the contract are controlled by the definitions of "Daily Contract Quantity" and "Deliverability" set forth in Article I of the contract.

[Germane to: Special Issue No. 2 (Tr. 145-146); Point of Error 1, Appellants' Motion for Rehearing.]

POINT 5. The Court of Appeals erred in holding that the Trial Court properly submitted to the jury Special Issue No. 2 and Instruction No. 2 containing the definition of "Deliverability" from Article I(j) of the contract.

[Germane to: Special Issue No. 2 (Tr. 145-146); Point of Error 9, Appellants' Motion for Rehearing.]

POINT 6. The Court of Appeals erred in holding that Lively waived their objection to Special Issue No. 2 and Instruction No. 2 containing the definition of "Deliverability" from Article I(j) of the contract.

[Germane to: Special Issue No. 2 (Tr. 145-146); Point of Error 10, Appellants' Motion for Rehearing.]

POINT 7. The Court of Appeals erred in holding that the instructions to Special Issue No. 2 were relevant, were not a comment on the weight of the evidence, and did not cause the rendition of an improper judgment.

[Germane to: Special Issue No. 2 (Tr. 145-146); Plaintiffs' Motion for Judgment and Partial New Trial, ¶ 7 (Tr. 160-163); Points of Error 11 and 12, Appellants' Motion for Rehearing.]

POINT 8. The Court of Appeals erred in holding that the Trial Court fairly submitted Special Issue No. 2, which was the controlling issue, and properly conditionally submitted Special Issue No. 3, which was the damage issue.

[Germane to: Special Issues No. 2 and 3 (Tr. 145-147); Plaintiffs' Motion for Judgment and Partial New Trial, ¶ 7 (Tr. 160-163); Point of Error 15, Appellants' Motion for Rehearing.]

POINT 9. The Court of Appeals erred in holding that Lively conceded that the evidence of the Gas Market Demand Rule supports the jury finding in Special Issue No. 2.

[Germane to: Point of Error 17, Appellants' Motion for Rehearing.]

Point 10. The Court of Appeals erred in holding that there was evidence to support the jury's finding on take-or-pay liability.

[Germane to: Plaintiffs' Motion for Judgment and Partial New Trial, ¶ 7 (Tr. 160-163); Point of Error 18, Appellants' Motion for Rehearing.]

POINT 11. The Court of Appeals erred in holding that legally incorrect evidence can be relied upon to support the jury's finding on take-or-pay liability.

[Germane to: Point of Error 19, Appellants' Motion for Rehearing.]

POINT 12. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to

relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals is pre-empted by the Natural Gas Policy Act.

[Germane to: Point of Error 23, Appellants' Motion for Rehearing.]

POINT 13. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals violates the Commerce Clause of the United States Constitution.

[Germane to: Point of Error 24, Appellants' Motion for Rehearing.]

FACT STATEMENT

This is a general fact statement germane to all points.

The contract in question (P. Ex. 1, S.F. 115) was entered into in 1973 between Lively and Valero's predecessor, Lo-Vaca Gathering Company. It grants to Valero the exclusive right and the obligation to purchase all of Lively's gas from the Contract Area for a period of 20 years.

The contract provides that Valero will, for each Contract Year, either (1) take delivery of and pay for the Daily Contract Quantity of natural gas or (2) pay for the Daily Contract Quantity of natural gas, whether taken or not. The Daily Contract Quantity is defined as a quantity of gas equal to ninety percent (90%) of Lively's

daily deliverability of gas averaged over the Contract Year. The quantity of gas to be purchased by Valero taken or not. The Daily Contract Quantity is defined as a each Contract Year is determined by multiplying the Daily Contract Quantity by the number of days during the Contract Year during which Valero's performance was not excused by the contract.

Article V, ¶ 5.3, of the contract provides in pertinent part as follows:

> Subject to the other provisions hereof, Buyer agrees to purchase and pay for (*or*, if Buyer's performance hereunder is not excused by other provisions of this Agreement, *pay for, if available, whether taken or not*) during the days of each contract year of the term hereof *a Daily Contract Quantity of gas from Sellers' Lands and Leases in the Contract Area equal to ninety percent (90%) of Sellers' daily Deliverability of gas hereunder.* Upon request by Buyer or Seller, *Sellers' Deliverability shall be determined and established by Buyer by testing the actual ability of Sellers' wells to deliver into Buyer's facilities at the points of delivery;* provided, however, neither Seller nor Buyer shall request such Deliverability test more often than once in any ninety (90) day period. Such Deliverability tests shall be made after a stabilized rate of flow has been achieved against such pressure as is required to deliver into Buyer's facilities at the operating pressure at the points of delivery at the time of the test. . . .[2]

This provision in the contract is commonly known in the oil and gas industry as a "take or pay" clause. Mr. Lively testified that he would not have executed the contract if this provision had not been included (S.F. 121).

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2. Emphasis added throughout except where indicated otherwise.

The contract also contains a general definition of the term "deliverability" which differs from the specific use of that term in the take-or-pay provision quoted above. Article I(j) of the contract defines the term "deliverability" as:

> [T]hat quantity of gas which Seller has available for delivery from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction. Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects to take hereunder up to the maximum quantity which in accordance with good engineering and gas production practice can be produced from Seller's wells in the fields.

Beginning with the 1982 Contract Year (June 1, 1982 - May 31, 1983), and continuing through the 1985 Contract Year, Valero failed to either take and pay or simply pay for the minimum quantity of gas as required by the contract.

Pursuant to Article VIII, ¶ 8.2, of the contract, Lively calculated the amount due from Valero under the take-or-pay provision to be $21,264,689.30 (P. Ex. 51; S.F. 398).

Article VIII, ¶ 8.2, provides:

> If Buyer shall fail in any contract year of the term hereof to take the quantity of gas that Buyer is obligated to take hereunder, then Seller shall, within sixty (60) days after such contract year render a bill to Buyer based upon the weighted average price, including tax reimbursement, in effect hereunder during the contract year in which such deficiency occurred, computed on the volumes delivered during the year and at the price, including tax reimbursement, applicable to such volumes at the time of delivery thereof. If Buyer agrees with such statement, Buyer will make payment to Seller for the amount of such statement within sixty (60) days after receiving Seller's statement. In computing the amount due Seller for any deficiency in takes by Buyer occurring during any contract year, there shall be deducted from such deficiencies the following quantities:
>
> (a) The total of the quantities which Buyer requested, up to 111% of the Daily Contract Quantity, and which Seller failed to deliver for any reason on any day or days during such contract year; and,
>
> (b) The total of the quantities of gas which Buyer was unable to take or failed to take on any day or days during such contract year by reason of force majeure; and,
>
> (c) The total of the quantities of gas by which there was a deficiency in Seller's allowable for the wells covered hereby below the Daily Contract Quantity on any day or days during such year, excluding any portion of such deficiency which is caused by, or is a result of, Buyer's failure to nominate to the Texas Railroad Commission to purchase a quantity of gas equal to the Daily Contract Quantity; and

> (d) The total of the quantities of gas which Buyer refuses to take on any day or days during such year by reason of Seller's failure to meet any of the quality specifications or pressure requirements provided hereunder.

In asserting that it had no liability to Lively under the take-or-pay provision of the contract, Valero relied upon evidence that it took the amount of gas under the contract that it was authorized to take under the Gas Market Demand Rule of the Railroad Commission of Texas (S.F. 675-699, 1306-1377; D. Exs. 7, 78, 91; Tr. 45-50). The amount of gas Valero took under its contract with Lively was determined by Valero's market demand for gas as reflected in its monthly nominations for gas filed by Valero with the Railroad Commission (D. Exs. 62-62M).

The Trial Court submitted Lively's take-or-pay claim by way of two special issues to the jury. Special Issue No. 2 inquired whether "Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)" (Tr.145). Special Issue No. 3, concerning the amount of money that Valero owed to Lively for its failure to take or pay under the contract, was conditionally submitted by the Trial Court upon an affirmative finding being made by the jury to Special Issue No. 2 (Tr. 147). Since the jury answered Special Issue No. 2 in the negative, it did not answer Special Issue No. 3. On the basis of the jury's answer to Special Issue No. 2, the Trial Court entered judgment against Lively on its take-or-pay claim. Other special issues were submitted to the jury, and the part of the judgment incorporating the jury's findings on them was not appealed.

The Court of Appeals, in affirming the Trial Court's judgment, relied upon the general definition of "Deliverability" contained in Article I(j) of the contract and upon the government regulation clause in Article XIII, ¶ 13.1, making the agreement "subject to all valid applicable federal and state laws . . . and to the orders, rules and regulations of any federal or state regulatory body or authority having jurisdiction." (Court of Appeals' Opinion, pp. 3-4).

Plaintiffs' Exhibits 38-41 vividly show how Valero has manipulated its nominations of, and requests for, gas by comparing the quantities requested by Valero with the Daily Contract Quantities under the contract. During the period June 1, 1982 - May 31, 1986, the quantities requested by Valero were progressively reduced. During the 1985 Contract Year, the quantities requested by Valero averaged less than 1000 Mcf per day for 4 months and were virtually zero for 6 months, while the Daily Contract Quantity for that same period was 7080 Mcf per day.

SUMMARY OF ARGUMENT

This case should be reversed and judgment rendered that Valero is liable to Lively for its failure to pay for the Daily Contract Quantity under the contract for the Contract Years 1982, 1983, 1984, and 1985, and the case should be remanded for a new trial as to the amount owed to Lively by Valero.

The Trial Court and the Court of Appeals erred in failing to hold as a matter of law that Valero is not relieved of liability under the take-or-pay provision of the contract by the application of the Texas Gas Market

Demand Rule and in permitting the jury to pass upon this legal question. In so doing, the Court of Appeals ignored established rules of construction of contracts and in effect read out of the contract the important take-or-pay provision.

The courts below also erred in submitting, or approving the submission of, instructions to the jury in connection with Special Issue No. 2 which contained an improper definition of "Deliverability" for use in determining take-or-pay liability and were improper comments on the weight of the evidence which caused the rendition of an improper judgment. Error was committed in submitting Special Issue No. 2, which was not the controlling issue, and in conditionally submitting Special Issue No. 3, the controlling issue. Further, there was no evidence to support the jury's finding on take-or-pay liability, since the only evidence was legally incorrect.

The Court of Appeals' application of the Gas Market Demand Rule is invalid, because the Rule as applied by the Court is pre-empted by the Natural Gas Policy Act and violates the Commerce Clause of the United States Constitution.

ARGUMENT AND AUTHORITIES

POINTS OF ERROR 1-4. IN SUMMARY: THE COURT OF APPEALS ERRED IN HOLDING THAT THE TEXAS GAS MARKET DEMAND RULE APPLIED SO AS TO RELIEVE VALERO OF ANY TAKE-OR-PAY LIABILITY UNDER THE CONTRACT.

The effect of the judgment and the Court of Appeals' opinion is to hold that because of the Texas Gas Market

Demand Rule Valero has no liability to Lively under the take-or-pay provision of the contract. This is contrary to the clear and unambiguous provisions of the contract and the applicable rules of construction and has the effect of reading the take-or-pay provision out of the contract.

This is the first time a Texas court has made such a holding, and its ramifications are for reaching and will have a severe, adverse effect on gas producers in this state.

Article V, ¶ 5.3, of the contract contains the take-or-pay provision relied upon by Lively in this case. Valero seeks to avoid its obligations under that provision by asserting that the Railroad Commission Gas Market Demand Rule abrogates the take-or-pay provision by limiting Valero's obligation to take gas to its market demand and consequently relieves Valero of its obligation to pay for the Daily Contract Quantity when not taken. It is Petitioners' position that as a matter of law the Gas Market Demand Rule does not affect the rights and obligations of the parties to this contract by relieving Valero of its obligation to pay for the minimum quantity of gas provided by the contract.

Take-or-pay provisions have been recognized as standard provisions in gas purchase agreements since the early 1950's. 4 H. WILLIAMS & C. MEYERS, OIL & GAS LAW § 724.5 (1983). Courts have consistently held that such provisions are common in the industry and are not unconscionable or unfair. *Universal Resources Corp. v. Panhandle Eastern Pipeline Co.*, 813 F.2d 77 (5th Cir. 1987). The purpose of such clauses is to apportion the risks of natural gas production and sales between the seller and buyer. "The seller bears the risk of production.

To compensate seller for that risk, buyer agrees to take, *or pay for if not taken,* a minimum quantity of gas." *Universal Resources,* 813 F.2d at 80.

The Gas Market Demand Rule clearly does not relieve Valero of its alternative obligation to pay for the Daily Contract Quantity of gas as required by the take-or-pay provision of the contract. That rule and the associated ratable-take requirements relate to the *production* and *taking* of gas to prevent waste and protect correlative rights. They do not regulate the *payment* for as not taken under take-or-pay provisions of natural gas contracts. *Resources Investment Corp. v. Enron Corp.,* 669 F.Supp. 1038 (D. Colo. 1987). No Texas statute or Railroad Commission regulation, either expressly or by implication, prohibits or excuses a purchaser from *paying for* the quantity of gas for which that purchaser has contractually obligated itself to pay. Valero itself recognizes that there is nothing in the Gas Market Demand Rule that prevents Valero from paying for a deficiency when it exists by operation of the take-or-pay provision (S.F. 840).

The Railroad Commission and the courts have recognized that contractural obligations to pay for gas not taken are not superseded by the Gas Market Demand Rule.

An attempt by the Railroad Commission to declare by regulation that the Gas Market Demand Rule relieved purchasers of contractual take-or-pay obligations was held invalid almost immediately after its adoption. On February 22, 1977, the Railroad Commission issued an interpretive order relating to the Gas Market Demand Rule, in which the Commission attempted to declare that take-

or-pay provisions were invalid to the extent they contravened the provisions of that order. What has become known as the "penultimate paragraph" read as follows:

> IT IS FURTHER ORDERED that the provisions of any and all purchase or other agreements between producers and gas purchasers which contravene or are inconsistent with the provisions of this Order and [sic] are rendered inoperative, including, without limitation, provisions relative to (1) gas purchasers nominating to take gas in certain amounts or at certain levels, (2) producers asserting penalties, damages or other remedies against gas purchasers in the event of reductions in or cancellation of allowables and (3) *obligations requiring gas purchasers to take, or pay for it not taken, quantities greater than allowables set by this Commission.*

Railroad Commission Gas Well Allowable Order, 2 TEX. REG. 785, 788 (1977).

Three lawsuits were filed in the Travis County district courts challenging the validity of that order. In one of those cases, *Dallas Production Co. v. Railroad Commission*, No. 260,641 (Dist. Ct. of Travis County, 53rd Judicial District of Texas, June 10, 1977), the plaintiff asserted that the above-quoted paragraph was invalid because the Railroad Commission had exceeded its statutory authority by attempting to regulate take-or-pay contracts.[3] The Court held that the order was unlawful, invalid, and of no force and effect, stating:

> The Court further finds that the above quoted penultimate paragraph herein declared invalid does not affect the rights, duties or obligations of Brazos

3. Appendix at A1-A2.

> Electric Power Cooperative, Inc. and Brazos Fuel Company, Inc., Intervenors, and Plaintiff producers under the take or pay provisions of their gas purchase agreements.

The Railroad Commission did not appeal this judgment and subsequently repromulgated the order without the invalid paragraph, and it became regularly adopted as what is commonly referred to as the Gas Market Demand Rule. 3 TEX. REG. 324 (1978). That rule, with minor revisions, was in effect during the 1982-1986 period covered by this litigation.

From the history surrounding its adoption, it is plain that the Gas Market Demand Rule does not and cannot have the effect of overriding take-or-pay provisions in gas purchase agreements between producers and purchasers and does not provide a defense for the breach of those contractual obligations. This is clear from the Travis County district court's holding that the portion of the interpretive order which stated that the rule superseded private contractual provisions was invalid and the Railroad Commission's subsequent omission of the offending language in the replacement interpretive order.

In adopting the current Gas Market Demand Rule, Rules 30 and 34 (sections 3.30 and 3.34), the Railroad Commission again stated that such regulations were not intended to modify existing private contractual relationships. In the preamble to those rules, the Railroad Commission carefully describes the scope of those rules:

> Sections 3.30 and 3.34 are not intended to be a comprehensive statement of rights or obligations under the Common Purchaser Act, nor are they intended to preclude any complaints which may

> arise under that Act. *These amendments shall not affect existing contractual rights and obligations between parties.* 12 TEX. REG. 536 (1987).

The above history of the Gas Market Demand Rule is discussed in *Valero Transmission Co. v. Mitchell Energy Co.*, 743 S.W.2d 658 (Tex. App.—Houston [1st Dist.] 1987), where the Court held that the Railroad Commission's prorationing and ratable take system does not interfere with the terms of gas purchase contracts. The Court there held:

> Although the Texas Railroad Commission is given general statutory authority to regulate the production of gas, the Commission does not have authority to hear contract disputes or to abrogate the parties' respective rights under the gas purchase contract. *See Railroad Comm'n v. City of Austin*, 524 S.W. 2d 262 (Tex. 1975); *see also Humble Oil & Refining Co. v. Railroad Comm'n*, 133 Tex. 330, 128 S.W.2d 9 (1939); *Railroad Comm'n v. United Gas Pipe Line Co.*, 358 S.W.2d 907 (Tex. Civ. App.—Austin 1962, writ ref'd n.r.e.); A. Anderson, The Texas Approach to Gas Proration and Ratable Take, 57 U. Colo. L. Rev. 199, 220-21 (1986). Indeed, the Texas Railroad Commission, in adopting 16 Tex. Admin. Code secs. 3.30, 3.34 (1987), has itself expressly acknowledged that these rules "shall not affect existing contractual rights and obligations between parties." 12 TEX. REG. 536 (February 17, 1987).

Id. at 660.

The Court stated further:

> [A]s discussed above, the Railroad Commission has no authority to abrogate contract rights. Nor do the Railroad Commission rules purport to affect contract

> rights. 12 TEX. REG. 536. A previous attempt to preempt contractual provisions that were inconsistent with a Railroad Commission interpretive order was struck down by the District Court of Travis County on a complaint that the Commission had exceeded its authority. *See Dallas Production Co. v. Railroad Comm'n*, No. 261,641 (Travis Cty. Dist. Ct., June 10, 1977).

Id. at 661-662.

Prior to the opinion of the Court of Appeals in this case, all Texas courts passing on the question rejected a Gas Market Demand Rule defense to a take-or-pay claim. In *Phillips v. Delhi Gas Pipeline Corp.*, No. 83-141 (Dist. Ct. of Houston County, 3rd Judicial District of Texas, Oct. 21, 1986),[4] the defendants raised the Gas Market Demand Rule as a defense to the plaintiffs' take-or-pay claim. The Court, in granting partial summary judgment, stated that "Defendants are liable for failing to take delivery from or pay Plaintiffs for the Daily Contract Volume of natural gas during each of the Annual Periods" and that the Gas Market Demand Rule and other defenses asserted by the pipeline "are not legally sufficient defenses to Plaintiffs' claims." *See also El Paso Natural Gas Co. v. G.H.R. Energy Corp.*, No. 85-09329 (Dist. Ct. of Harris County, 127th Judicial Dist. of Texas, Oct. 10, 1986),[5] where the Court, in granting the producers' motion for partial summary judgment, held that, "as a matter of law, the take-or-pay provision . . . is enforceable and performance is not excused on any basis, . . . including regulation by federal or state governmental authority. . . ."

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4. Appendix at A3.

5. Appendix at A4.

The United States District Court, Southern District of Texas, Houston Division, in *McGoldrick Oil Company, et al. v. United Gas Pipe Line Company*, Civil Action No. H-84-4971, hereinafter discussed, *infra* p. 46, also struck down a defense by the pipeline company based upon the Gas Market Demand Rule.

In *Resources Investment Corp. v. Enron Corp.*, 669 F.Supp. 1038 (D. Colo. 1987), the court held that the enforcement of a take-or-pay clause did not violate the Texas Gas Market Demand Rule. In striking and dismissing a counterclaim and defense based on the conservation statutes, specifically including the Texas rule, the Court pointed out that the statute was inapplicable because the take-or-pay provisions of the gas purchase contracts did not require production, but, rather, provided for payment in lieu of production. 669 F.Supp. at 1041.

The Court of Appeals upheld Valero's assertion that as a result of the application of the Gas Market Demand Rule to this contract Valero has no contractual take-or-pay obligation. Under Valero's theory, the Gas Market Demand Rule requires Valero to limit its purchases of gas from any producer to that producer's proportionate share of the downstream market demand. In essence, Valero argues that deliverability under the contract is determined by Valero's market demand. Under Valero's contention, Valero's takes will always equal deliverability, and there can never be a deficiency under the take-or-pay provision of the contract requiring Valero to pay for gas not taken.

The Court of Appeals adopted a construction of the contract in the light of a rule that was adopted by the Railroad Commission several years *after* the contract

was entered into. The Court based its action in part upon a general government regulation clause. (Article XIII, ¶ 13.1) that appears in every natural gas contract. The Court's holding in that respect would eliminate "take-or-pay" liability under all natural gas contracts. The Court's opinion renders meaningless and gives no effect to the "take-or-pay" provision of the contract. It places a legal stamp of approval on Valero's manipulation of its nominations and takes of gas under the contract in a manner that was clearly never intended by the parties and completely relieves Valero of any liability under the "take-or-pay" provision of the contract.

The Court of Appeals' holding not only is contrary to the clear and unambiguous language of the "take-or-pay" provision of the contract but also is a direct contradiction of the history of the Texas Gas Market Demand Rule and the Railroad Commission's stated intent that the Gas Market Demand Rule "shall not affect existing contractual rights and obligations between parties." 12 TEX. REG. 536 (1987). Further, the Court's action nullifies a provision that has been recognized as a standard provision in gas contracts for over thirty years and has been upheld by the courts consistently as being conscionable and fair and as properly apportioning the risks between the buyer and seller of gas.

Valero's contention and the Court of Appeals' opinion fail to recognize the purpose and effect of the alternative performance obligations under the take-or-pay provision of the contract. The courts have recognized that the take-or-pay clause is an alternative performance provision. *International Minerals & Chemical Corp. v. Llano, Inc.*, 770 F.2d 879 (10th Cir. 1985); *Superior Oil Co. v.*

Transco Energy Co., No. 84-2138-"L" (W.D. La. 1985).[6] Valero can perform by either (1) taking and paying for the specified minimum quantity of gas for the Contract Year or (2) paying for that minimum quantity of gas even though not taken during the Contract Year.

In *International Minerals*, the defendant International Minerals ("IMC") was the operator of a potash mine and processing facility in New Mexico. In 1972, IMC entered into a contract with plaintiff to purchase gas needed to run some of its equipment. In 1978, the New Mexico Environmental Improvement Board enacted Regulation 508, which limited emissions from potash processing equipment. In employing new technology necessary to comply with the regulation, IMC did not take or pay for the minimum quantity of gas as required under the contract. IMC alleged that the enactment of Regulation 508 was an event of force majeure and relieved it of any performance obligations under the gas purchase contract. The court rejected that position, stating:

> [E]ven if we assume arguendo that Rule 508 prevented IMC from taking the gas, Rule 508 would still pose no obstacle to IMC's ability to pay. Since this is a "take-or-pay" contract the buyer can perform in either of two ways. It can either (1) take the minimum purchase obligation of natural gas (and pay) or (2) pay the minimum bill. It is settled law that when a promisor can perform a contract in either of two alternative ways, the impracticability of one alternative does not excuse the promisor if performance by means of the other alternative is still practicable. (Citations omitted) *Paragraph 15* [*the force majeure clause*] *does not compel a different result;*

6. Appendix at A5.

it would at most excuse IMC from its duty to "take," not from its duty to "pay."

770 F.2d at 885.

In *Kaiser-Francis Oil Co. v. Producer's Gas Co.*, No. 83-C-400-B (N.D. Okla. June 19, 1985),[7] and *Southport Exploration Inc. v. Producer's Gas Co.*, No. 83-C-550-B (N.D. Okla. June 6, 1984),[8] the courts addressed the argument that a pipeline company had no obligation to make take-or-pay payments because production of the gas not taken would have exceeded the market demand for the gas and thus would have constituted waste under the Oklahoma conservation statutes. The court in *Kaiser-Francis*, recognizing the alternative performance obligations of a take-or-pay provision, specifically held that take-or-pay provisions are enforceable under the state market demand rule and statutes intended to prevent waste since *"the take-or-pay provisions of the contract do not require production, but rather provide for payment in lieu of production."*[9] In rejecting the pipeline company's argument, the Court stated that *"such an interpretation would render the take-or-pay provisions of the contracts virtually useless."*[10]

The definition of "waste" is virtually the same in the Texas and Oklahoma conservation statutes. Section 86.012 of the TEXAS NATURAL RESOURCES CODE defines the term waste to include "the production of gas in excess of transportation or market facilities or reasonable

7. Appendix at A36.

8. Appendix at A47.

9. Appendix at A46.

10. Appendix at A42.

market demand for the type of gas produced." Section 86.3 of 52 OKLAHOMA STATUTES ANNOTATED provides "the term 'waste', as applied to gas, in addition to its ordinary meaning, shall include . . . waste incident to the production of natural gas in excess of transportation and marketing facilities or reasonable market demands."

The Oklahoma Supreme Court has recently written on this same issue in *Golsen v. ONG Western, Inc.*, ____ P.2d____ (Okla. 1988) (not yet reported).[11] In reversing the trial court's finding based on the application of those same conservation statutes, the Court stated:

> The trial court held also that production in excess of market demand was waste under the definition of that term in 52 O.S. 1981 § 86.3, and that the statutory prohibition against production of gas so to constitute waste contained in that statute combine to prohibit plaintiffs' tender of any more gas than was actually taken. Section 86.3 provides the term waste shall include waste incident to the production of natural gas in excess of transportation and marketing facilities or reasonable market demand. Here the statute again focuses on production. The statute is not directed to payment for gas not taken, but to waste incident to production in excess of reasonable market demand. In this situation the plaintiff-producer has a market for his gas and is, indeed, seeking to enforce that market through the courts. The producer's contract is proof that he has a market and it is that market he is trying to enforce here.[12]

Alternative performance obligations have consistently been upheld by Texas courts. *Moss & Raley v. Wren*, 102

11. Appendix at A60.

12. Appendix at A71.

Tex. 567, 120 S.W. 847 (1909); *Kirkland v. Gaston,* 544 S.W.2d 694 (Tex. Civ. App.—Dallas 1976, no writ); *Carter v. Smith,* 184 S.W. 244 (Tex. Civ. App.—Dallas 1916, no writ). Where a contract provides for alternative performance obligations, the fact that one alternative is prevented does not relieve the party from performing the second alternative. *Yankton Sioux Tribe of Indians v. United States,* 272 U.S. 351 (1926); *Ashland Oil & Refining Co. v. Cities Service Gas Co.,* 462 F.2d 204 (10th Cir. 1972); S. WILLISTON, CONTRACTS § 1961 (1971 and 1984 Supp.).

Valero's position and the Court of Appeals' opinion render meaningless not only to the take-or-pay provision in Article V, ¶ 5.3, but also Article VIII, ¶ 8.2. That paragraph sets forth the method of "computing the amount due Seller for any deficiency in takes by Buyer occurring during any contract year." Paragraph 8.2(c) specifically provides that in computing the deficiency in takes by Buyer during the Contract Year, the Buyer is not entitled to any credit for any deficiency which is "caused by, or is a result of Buyer's failure to nominate to the Texas Railroad Commission to purchase a quantity of gas equal to the Daily Contract Quantity." The interpretation of the contract advanced by Valero would always equate Daily Contract Quantity with Valero's nominations, and there can never be any deficiency. If that interpretation is correct, the language in ¶ 8.2(c) is superfluous.

If the Gas Market Demand Rule has the effect given it by Valero and the court below, the take-or-pay provision of the contract becomes meaningless. If the original parties to the contract intended that there could never

be any take-or-pay liability, then why did they include a take-or-pay provision in the contract and why was that a requirement of the contract insofar as Lively was concerned?

It is well recognized that parties to an instrument intend every clause to have some effect and purpose and in some measure to evidence their agreement, and this purpose should not be thwarted. *Woods v. Sims,* 154 Tex. 59, 273 S.W.2d 617, 620 (1954); *Pinehurst v. Spooner Addition Water Co.,* 432 S.W.2d 515 (Tex. 1968); RESTATEMENT OF THE LAW OF CONTRACTS § 230 (1932). Thus, Texas case law makes it clear that a contract should be construed in a manner which gives effect to all of its provisions. *Coker v. Coker,* 650 S.W.2d 391 (Tex. 1983); *Universal C.I.T. Credit Corp. v. Daniel,* 150 Tex. 513, 243 S.W.2d 154 (1951); *Sun Oil Co. v. Burns,* 125 Tex. 549, 84 S.W.2d 442 (1935); *Williams v. J & C Royalty Co.,* 254 S.W.2d 178 (Tex. Civ. App. —San Antonio 1952, writ ref'd). Accordingly, courts should avoid the adoption of a construction which would render any provision meaningless. *Mattison, Inc. v. W. F. Larson, Inc.,* 529 S.W.2d 271 (Tex. Civ. App.—Amarillo 1975, writ ref'd n.r.e.). A court has no right to nullify any terms of an agreement. *Williams v. J & C Royalty Co., supra.* Courts are instructed to adopt a construction of a contract which gives effect to all of its provisions and avoid the adoption of a construction that would render any provision meaningless. *R & P Enterprises v. LaGuarta, Gavrel & Kirk, Inc.,* 596 S.W. 2d 517 (Tex. 1980). Observance of the above rules in this case requires rejection of the interpretation placed on the contract by Valero and the Court of Appeals.

The take-or-pay provision in Article V, ¶ 5.3, is complete and sufficient in itself in defining the obligations of Valero with respect to the minimum quantity of gas to be taken or paid for under the contract. The provision contains its own definition of *"Seller's Deliverability,"* which is to be used *"hereunder."* The specific language included in the take-or-pay provision cannot be and is not changed by the general definition of "Deliverability" contained in Article I(j). Under the take-or-pay provision, the Daily Contract Quantity to be paid for if not taken is 90% of *"Sellers'* daily *Deliverability* of gas *hereunder,"* which "shall be determined and established by Buyer by testing the *actual ability of Sellers' wells to deliver into Buyer's facilities at the points of delivery."*

"If an instrument contains clauses apparently in conflict, they should be reconciled, if it can be done by a reasonable interpretation; that is, 'such a construction as will make the agreement fair, customary, and such as prudent businessmen would naturally execute.' " *Stone v. Robinson*, 180 S.W. 135, 136 (Tex. Civ. App.—Amarillo 1915, writ ref'd). In this instance, the fair and reasonable interpretation, the construction which would make the agreement one which would be executed by a prudent businessman, is the interpretation which gives effect to the take-or-pay provision. Mr. Lively himself testified that he would not have executed the contract if the take-or-pay provision had not been included therein (S.F. 121).

In *Golsen v. ONG Western, Inc., supra* p. 23, the Court found that the defendant purchaser's defense of force majeure on the basis of the inclusion of the phrase "failure of gas supply or markets" in the force majeure

clause of the contract "frustrated the basic premises of the contract." In discussing this issue, the Court stated:

> Insofar as the trial court held that the term "failure of markets" in this contract refers to a decline in demand of the product, the trial court also erred. 12 O.S. 1981 § 157 provides that the whole of a contract is to be construed together if reasonably practicable so that each clause is an aid to interpreting the others. Additionally, contracts should be construed so that any repugnancy in a contract is reconciled if possible, by such an interpretation as will give some effect to the repugnant clause which is subordinate to the general intent and purposes of the whole contract. 12 O.S. 1981 § 168. This gas sales contract consists of approximately thirty pages. Throughout the document the general purpose or intent is to arrange the purchase and sale of gas. These provisions give the defendant an exclusive right to take plaintiffs' gas for a term of years at a set price. The defendant acquires a contractually-assured supply while the plaintiffs are assured a market; both parties doing so at a price which is an agreed part of the bargain. Secondly, the plaintiffs relinquish their right to sell gas to third parties and the plaintiffs in return are paid for a minimum annual quantity of gas whether or not taken in that year. The parties are assuring themselves of the ability to purchase and sell for a term of years.
>
> The force majeure clause as interpreted by the defendant is repugnant to this general purpose. Defendant urges that the inclusion in the force majeure clause of the phrase "failure of gas supply of markets" should be read with the language in the first line of the clause "in whole or in part" so that the language would relieve it of the obligation to take

> at all, or to pay if not taken, where there is a decline in demand. Such an interpretation frustrates the basic premises of the contract virtually entirely. It would eliminate the requirement to pay for gas not taken as a practical matter, for any contract amount not taken would be the result of a partial failure of demand.[13]

The real issue in this lawsuit is what does the take-or-pay provision of the contract require of Valero. A fair and reasonable reading of that provision is that Valero is obligated to take or pay for 90% of Lively's daily deliverability as determined by actual testing of the wells. This interpretation does not violate any of the other provisions of the contract, gives real meaning to the take-or-pay provision, and carries out the original parties' intention. The construction sought by Valero and adopted by the Court of Appeals does not do justice to the contract or the parties, as it completely ignores the intent of the parties in including a take-or-pay provision in the contract.

If the take-or-pay provision in the contract is to have meaning, Valero must be prohibited from using its nominations to the Railroad Commission as a means of manipulating its take-or-pay liability. To hold otherwise defeats the clear intent of the original parties to the contract.

For the above reasons, the Court of Appeals erred as a matter of law in sustaining Valero's position and affirming the Trial Court's judgment.

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13. Appendix at A66-A67.

POINTS OF ERROR 5-6. IN SUMMARY: THE COURT OF APPEALS ERRED IN HOLDING THAT THE TRIAL COURT PROPERLY SUBMITTED SPECIAL ISSUE NO. 2 AND INSTRUCTION NO. 2 CONTAINING THE DEFINITION OF "DELIVERABILITY" FROM ARTICLE I(J) OF THE CONTRACT AND THAT LIVELY WAIVED THEIR OBJECTION THERETO.

The Trial Court in the instructions to Special Issue No. 2 defined the term "Deliverability" as set forth in Article I(j) instead of as set forth in Article V, ¶ 5.3, which is the take-or-pay provision of the contract. Under the contract, Valero's take-or-pay liability is determined by comparing actual purchases of gas to "ninety percent (90%) of Seller's daily Deliverability of gas hereunder." The contract expressly sets forth how "Deliverability" is to be determined for take-or-pay purposes in Article V, ¶ 5.3, wherein it is stated:

> Upon request by Buyer or Seller, *Seller's Deliverability shall be determined and established by Buyer by testing the actual ability of Seller's wells to deliver into Buyer's facilities* at the points of delivery; provided, however, neither Seller nor Buyer shall request such Deliverability test more often than once in any ninety (90) day period. Such Deliverability tests shall be made after a stabilized rate of flow has been achieved against such pressure as is required to deliver into Buyer's facilities at the operating pressure at the points of delivery at the time of the test.

The evidence at trial established that Lively tested the actual ability of its wells to deliver into Valero's facilities and that the results of the tests were found in Lively's Form G-10 filings with the Railroad Commission (S.F. 227-231). The Trial Court admitted Lively's Form G-10's

into evidence (P. Ex. 13; S.F. 243). Lively calculated its take-or-pay damages based on the actual ability of the wells to deliver (P. Exs. 42, 49-51; S.F. 370, 442), inconformity with the express language of the take-or-pay provision in Article V, ¶ 5.3, of the contract.

The Trial Court, however, used the wrong definition of "Deliverability" in its instructions. The Court did not instruct the jury that "Deliverability" for take-or-pay purposes means the actual ability of the wells to deliver into Valero's facilities, but instead gave the following instruction in connection with Special Issue 2:

> Lively's daily 'Deliverability' is defined by the Contract to be that quantity of gas which Lively had available for delivery from the Lands and Leases to Valero during each day in conformity with the requirements of the Contract, at a constant rate of flow, when Lively's wells were not produced in excess of their maximum efficient rate of flow, but not in excess of the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction (Tr. 145).

Lively made extensive objections to Special Issue No. 2 and Instruction No. 2 in the trial court. Those objections were: (1) the issue should not be submitted because it was not a controlling issue and its submission deprived plaintiff of the unconditional submission of the controlling Special Issue No. 3; (2) the inclusion of the language of Article V, ¶ 5.2, of the contract in Instruction No. 2 was an error because there had been no evidence presented to warrant its submission, and it could serve only to mislead and confuse the jury by leading the jury to

believe that it relates to Valero's minimum take under the contract and possibly lead to an erroneous verdict on Special Issue No. 2 and possibly also on Special Issue No. 3; (3) the part of the instruction pertaining to waste was error because there was no evidence to warrant the submission of these instructions pertaining to waste and they could only mislead and confuse the jury and possibly result in an erroneous verdict; (4) these instructions were meaningless abstract statements of the law without reference to or connection with any evidence or issue in this case; (5) the instruction with respect to Valero's obligation under the Gas Market Demand Rule was an error because there was no evidence in the trial of the case that the Gas Market Demand Rule has affected any issue being presented to the jury for determination; (6) the Gas Market Demand Rule should have no bearing on the determination of the issue the jury was being asked to answer, and its inclusion in any form in the instruction could serve only to mislead and confuse the jury and possibly result in an erroneous verdict; (7) the instructions concerning the Gas Market Demand Rule are meaningless abstract statements of law without any reference to or connection with any issue in this case; and (8) there was no evidence that compliance with the Gas Market Demand Rule in any way affected Valero's ability to perform its obligations under the contract and particularly its pay obligation under the "take-or-pay" clause (S.F. 1675-1681).

Just as the Court of Appeals felt it was necessary to look at the entire Instruction No. 2 to determine whether it or any part thereof had an adverse effect on the jury, Lively's entire objections to Special Issue No. 2 and Instruction No. 2 should be considered to determine

their sufficiency on the question of waiver. Petitioners respectfully submit that when viewed in their entirety the extensive objections were sufficient and that there was no waiver that would preclude the consideration by the Court of Appeals or this Court of these points of error.

The Trial Court's error in submitting the wrong definition of "Deliverability" in its instructions to Special Issue 2 is shown by a comparison of the contract's use of the term in the definitions section of the contract (Article I(j)) and in the take-or-pay clause (Article V, ¶ 5.3):

Article I(j)	*Article V, ¶ 5.3*
(j) The term "Deliverability" means that quantity of gas which Seller has available for delivery from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.	Upon request by Buyer or Seller, *Seller's Deliverability shall be determined and established by Buyer by testing the actual ability of Seller's wells to deliver into Buyer's facilities at the points of delivery;* provided, however, neither Seller nor Buyer shall request such deliverability tests more often than once in any ninety (90) day period. Such deliverability tests shall be made after a stabilized rate of flow has been achieved against such pressure as is required to deliver into Buyer's facilities at the operating pressure at the points of delivery at the time of the test. . . .

To be proper, an explanatory instruction or definition must be correct. *Sanders v. Davila,* 593 S.W.2d 127 (Tex. Civ. App.—Amarillo 1979, writ ref'd n.r.e.). An explanatory instruction is improper if it is a misstatement of the law as applicable to the facts. *Wakefield v. Bevly,* 704 S.W.2d 339 (Tex. App.—Corpus Christi 1985, no writ). An erroneous definition given by the court may amount to prejudicial error requiring reversal. *Gage v. Langford,* 582 S.W.2d 203 (Tex. Civ. App.—Eastland 1979, writ ref'd n.r.e.). Furthermore, an instruction which shifts to the jury the determination of a legal issue that should have been determined by the Trial Court involves the submission to the jury of a question of law, which is improper and requires reversal. *Foerster v. Peoples,* 362 S.W.2d 918 (Tex. Civ. App.—Amarillo 1962, no writ); *Barton v. Davis,* 441 S.W.2d 299, 301 (Tex. Civ. App.—El Paso, writ ref'd n.r.e.); *Emmord's Inc. v. Obermiller,* 526 S.W.2d 562, 566 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.).

The definition submitted by the Trial Court required the jury to determine the legal issue of whether the Gas Market Demand Rule, a regulation by an administrative agency, modifies existing contractual relationships between private parties. As heretofore discussed, *supra* pp. 14-18, as a matter of law the Gas Market Demand Rule does not affect private contract rights.

Contrary to the Court of Appeals' statement, Lively did not concede "that the evidence of the Gas Market Demand Rule supports the jury finding in Special Issue No. 2." (Court of Appeals' Opinion, p. 13). Instead, it was and is Lively's position that there was no evidence to support that finding and that the Gas Market Demand

Rule has no legal effect upon Valero's obligation *to pay* Lively for the minimum quantity it was obligated to take or pay for under the contract. This is an alternative obligation which is not affected or excused by the Gas Market Demand Rule.

The Trial Court's erroneous definition of the term "Deliverability" in the instructions to Special Issue No. 2 was reasonably calculated to cause and did cause the rendition of an improper judgment, and the Trial Court's judgment should be set aside.

POINT OF ERROR 7: THE COURT OF APPEALS ERRED IN HOLDING THAT THE INSTRUCTIONS TO SPECIAL ISSUE NO. 2 WERE RELEVANT, WERE NOT A COMMENT ON THE WEIGHT OF THE EVIDENCE, AND DID NOT CAUSE THE RENDITION OF AN IMPROPER JUDGMENT.

The Trial Court's submission of Special Issue No. 2 and Instruction No. 2 tainted the entire submission to the jury. The erroneous and superfluous instructions to the jury concerning the Gas Market Demand Rule, waste, ratable take, maximum rate of flow permitted by the Railroad Commission, and information to be supplied the Railroad Commission (1) confused and misled the jury by causing them to believe that because of the Gas Market Demand Rule there could be no liability of Valero to Lively under the contract; (2) constituted an impermissible comment that tilted or nudged the jury in favor of Valero; and (3) improperly shifted to the jury the determination of a question of law as to the applicability and effect, if any, of the Gas Market Demand Rule on the "take-or-pay" obligation of Valero under the contract.

The Trial Court's instructions given with respect to Special Issue No. 2 were prejudicial comments on the weight of the evidence. In Instruction No. 2, the Court stated, in part:

> The term market demand means that amount of gas needed for current consumption.
>
> You are instructed that the production, transportation, or use of gas in a manner, in an amount, or under conditions which constitute waste is unlawful and is prohibited.
>
> You are instructed that the term "waste" includes the production of gas in excess of transportation or market facilities or reasonable market demand for the type of gas produced (Tr. 146).

These instructions by the Trial Court constituted an impermissible comment that tilted or nudged the jury in favor of Valero, in violation of this Court's holding in *Lemos v. Montez*, 680 S.W.2d 798, 801 (Tex. 1984). There, this Court held that even legally correct instructions are not proper when they direct the jury towards a particular answer to a special issue. *Id.*

Here, even if the Trial Court's definition of the term "waste" is accurate, it was irrelevant. There was no need for the Court to instruct the jury on "waste." Valero had the option of fulfilling its obligations under the contract by either taking and paying for the Daily Contract Quantity or by merely paying for that gas. The contract neither obligates Lively to produce, nor Valero to purchase, gas wastefully. Instead, the contract specifically provides for payment in lieu of production. There are no conservation statutes prohibiting Valero from paying even when it cannot take gas.

The Trial Court further commented improperly on the weight of the evidence by its quote from Article V, ¶ 5.2, of the contract in Instruction No. 2, which stated:

> You are instructed that the Contract provides that subject to its other provisions, Valero shall have the right to purchase such quantity of gas per day as Valero may from day to day elect to purchase up to the total quantity per day which the wells are capable of producing when produced at their respective maximum efficient rates of flow, in Lively's sole judgment reasonably exercised, or at their respective allowable rates of flow under applicable orders, rules, regulations or laws, whichever is the lesser rate of flow (Tr. 145).

This instruction was not necessary to enable the jury to answer Special Issue No. 2. It impermissibly diverted the jury's attention from the central issue in Special Issue No. 2—Did Valero fail to take or pay for an amount of gas equal to the Daily Contract Quantity? Its effect is to imply to the jury that Valero controls the quantity of gas that it is required to take or pay for or pay for if not taken. This implication is clearly contrary to the express terms of the contract.

"Submission of unnecessary instructions may be so prejudicial as to require a reversal." *Samsel v. Diaz,* 659 S.W.2d 143, 145 (Tex. App.—Corpus Christi 1983, no writ). *Boaz v. White's Auto Store,* 141 Tex. 366, 172 S.W.2d 481, 484 (1943). An unnecessary instruction that constitutes a comment on the weight of the evidence or which diverts the jury's attention from a central issue is error. *Lemos v. Montez, supra* p. 35; *City of San Antonio v. Roper Corp.,* 686 S.W.2d 602 (Tex. 1985).

"It is the duty of the trial court to submit only such explanatory instructions as are proper so as to enable the jury to render a verdict." *Wakefield v. Bevly,* 704 S.W.2d 339, 350 (Tex. App.—Corpus Christi 1985, no writ); *Line Enterprises, Inc. v. Hook & Matteson Enterprises, Inc.,* 659 S.W.2d 113 (Tex. App.—Amarillo 1983, no writ); TEX. R. CIV. P. 277. "The only function of an explanatory instruction in the charge is to aid and assist the jury in answering the issues submitted by the court." *Rendon v. Texas Employers Insurance Association,* 599 S.W.2d 890, 896 (Tex. Civ. App.—Amarillo 1980, writ ref'd n.r.e.). Quoting G. HODGES, SPECIAL ISSUE SUBMISSION IN TEXAS § 8 at 25 (1959), the court in *Union Oil of California v. Richard,* 536 S.W.2d 955, 958 (Tex. Civ. App.—Beaumont 1975, writ ref'd n.r.e.), stated: "Anything else, however interesting, or, indeed, however relevant to the case in general, which does not aid the jury in answering the issues must be excluded."

The Trial Court's submission of Special Issue No. 2 and Instruction No. 2 totally confused and mislead the jury by causing them to believe that Valero was not required to take or pay for more gas under the contract than its market demand and that if the jury answered Special Issue No. 2 "Yes" it would itself be causing a violation of the law. Therefore, Special Issue No. 2 and Instruction No. 2, with all of their implications, ramifications, and meanings, confused and mislead the jury and resulted in an erroneous verdict and judgment.

"It is fundamental that only issues of fact should be submitted to the jury," and an instruction which shifts to the jury the determination of a legal issue that should have been determined by the trial court is improper and requires reversal. *See Knutson v. Ripson,* 346 S.W.2d

424, 426 (Tex. Civ. App.—Amarillo 1961), *aff'd* 163 Tex. 312, 354 S.W.2d 575 (1962); *Foerster v. Peoples,* 362 S.W.2d 918 (Tex. Civ. App.—Amarillo 1962, no writ); *Barton v. Davis,* 441 S.W.2d 299, 301 (Tex. Civ. App.—El Paso 1969, writ ref'd n.r.e.); *Emmord's Inc. v. Obermiller,* 526 S.W.2d 562, 566 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.).

The Trial Court should have held as a matter of law that the Gas Market Demand Rule does not affect private contract rights. Its failure to so hold, its further action in submitting this legal question to the jury for determination, and its action in confusing and misleading the jury by the contents of, and the undue emphasis of matters in, Instruction No. 2 resulted in the rendition of an improper judgment, which should be set aside.

POINT OF ERROR 8: THE COURT OF APPEALS ERRED IN HOLDING THAT THE TRIAL COURT FAIRLY SUBMITTED SPECIAL ISSUE NO. 2, WHICH WAS THE CONTROLLING ISSUE, AND PROPERLY CONDITIONALLY SUBMITTED SPECIAL ISSUE NO. 3, WHICH WAS THE DAMAGE ISSUE.

The errors in the Trial Court's instructions with respect to Special Issue No. 2 were compounded by the Court's conditionally submitting Special Issue No. 3, which was the ultimate or controlling issue in this case.

Rules 277 and 279 of the TEXAS RULES OF CIVIL PROCEDURE provide that each party is entitled to have submitted to the jury the controlling issues for each ground of recovery or defense raised by the written pleadings and evidence in the case. Texas courts have long recognized

this right. *Blanton v. E. & L. Transport Co.,* 146 Tex. 377, 207 S.W.2d 368 (1948); *Montgomery v. Gay,* 212 S.W.2d 941 (Tex. Civ. App.—Fort Worth 1948, no writ). "This right cannot be lost or defeated by jury findings on other issues, which, in effect indirectly negative a favorable finding on an issue not submitted, but raised by the evidence." *Blanton,* 207 S.W.2d at 369.

The conditional submission of special issues is not authorized where fundamental rights of the parties may be adversely affected. Accordingly, when the effect of conditionally submitting an issue is to deprive the plaintiff of the submission of an independent ground of recovery, conditioning the issue is erroneous. 3 R. McDONALD, TEXAS CIVIL PRACTICE IN DISTRICT AND COUNTY COURTS §§ 12.16.1 and 12.16.2(b) (rev. 1983). The only appropriate solution is to remand the matter for a new trial.

Under the rules relating to special issue practice, only controlling or ultimate issues should be submitted to the jury. TEX. R. CIV. P. 277 and 279; *Holmes v. J. C. Penney Co.,* 382 S.W.2d 472 (Tex. 1964); *Rocha v. Ahmad,* 676 S.W.2d 149 (Tex. App.—San Antonio 1984, writ dism'd). Evidentiary issues, those which are embrased within or tend only to establish the fact of the controlling issue, should not be submitted to the jury. *Lambert v. H. Molsen & Co., Inc.,* 551 S.W.2d 151 (Tex. Civ. App.—Waco 1977, writ ref'd n.r.e.) An evidentiary issue may be considered by the jury in deciding the controlling issue, but it is not a controlling issue itself and should not be submitted *Sell v. C. B. Smith Volkswagen, Inc.,* 611 S.W.2d 897 (Tex. Civ. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.).

As was argued by Lively at the charge conference (S.F. 1682-1683), Special Issue No. 3 was the ultimate and controlling issue in the case. The Daily Contract Quantity inquired about in Special Issue No. 2 was simply one of the many evidentiary matters to be considered by the jury in deciding the controlling issue. The Trial Court's conditional submission of the controlling issue in the case, predicated on a response to an evidentiary issue which should not have been submitted, deprived Lively of its right to have the controlling issue with respect to one of its grounds for recovery determined by the jury. In effect, Lively's entire cause of action was submitted conditionally.

The conditional submission of Special Issue 3 was extremely prejudicial to Lively, constituted harmful error, and likely led to the rendition of an improper judgment.

POINTS OF ERROR 9-11. IN SUMMARY: THE COURT OF APPEALS ERRED IN HOLDING THAT THERE WAS EVIDENCE TO SUPPORT THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY, THE ONLY EVIDENCE BEING LEGALLY INCORRECT.

Special Issue No. 2 asked the jury to find whether "Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)?" The jury answered "No." This finding is unsupported by any legally sufficient evidence.

The contract defines "Daily Contract Quantity" as that quantity of gas equal to ninety percent (90%) of Lively's daily deliverability. All of the evidence presented to the jury, with but one exception, showed that Valero failed to take or pay for the quantity of gas equal to the Daily

Contract Quantity. Lively presented extensive testimony concerning Valero's failure to take or pay for the Daily Contract Quantity during the Contract Years 1982, 1983, 1984, and 1985 (P. Exs. 38-42, 49-51, 57-60; S.F. 367-401). Even Valero's own evidence, with one exception, proved that Valero failed to take or pay for a quantity of gas equal to the Daily Contract Quantity. Valero recognized that there is nothing in the Gas Market Demand Rule that prevents Valero from paying for a deficiency when a deficiency exists by operation of the take-or-pay provision (S.F. 840).

Valero presented Herbert E. Warner, a partner with the accounting firm of Peat Marwick & Main, as an expert witness (S.F. 1384). Mr. Warner presented a series of exhibits calculating Valero's take-or-pay deficiency. Mr. Warner presented seven different "scenarios" showing Valero's take-or-pay deficiency. Six of these seven scenarios proved that Valero had failed to take or pay for a quantity of gas equal to the Daily Contract Quantity (D. Exs. 79-90). Only one out of Valero's own seven scenarios shows that Valero had not failed to take or pay for a quantity of gas equal to the Daily Contract Quantity (D. Exs. 78 and 91). However, *that one scenario is based solely on the assumption that the term "deliverability" is the equivalent of the amount of gas that Valero actually took from Lively pursuant to the Gas Market Demand Rule.* As heretofore discussed, the Gas Market Demand Rule does not abrogate Valero's obligation to pay for a quantity of gas equal to the Daily Contract Quantity. Valero's evidence based upon this erroneous assumption is equally incorrect and thus constitutes no evidence.

A "no evidence" point of error must be sustained when the record discloses one of the following:

(1) a complete absence of evidence of a vital fact;

(2) the court is barred by rules of law or evidence from giving weight to the only evidence offered to prove a vital fact;

(3) the evidence offered to prove a vital fact is no more than a mere scintilla of evidence; or

(4) the evidence establishes conclusively the opposite of a vital fact.

Royal Indemnity Co. v. Little Joe's Catfish Inn, Inc., 636 S.W.2d 530, 531 (Tex. App.—San Antonio 1982, no writ); Calvert, *"No Evidence" and "Insufficient Evidence" Points of Error*, 38 Tex. L. Rev. 361 (1960).

In the present case, the evidence presented by both parties conclusively establishes that Valero failed to take or pay for a quantity of gas equal to the Daily Contract Quantity during each of the Contract Years involved. The evidence to the contrary is based entirely on Valero's invalid argument that the Gas Market Demand Rule abrogates its obligations under the contract (S.F. 1449). Therefore, this Court is barred from considering the only evidence in the record which supports the jury's finding with respect to Special Issue No. 2.

When the jury finds the nonexistence of a vital fact or gives a negative answer to an issue inquiring as to the existence of a vital fact, its finding or answer need not be supported by evidence, and error can occur only if the facts have been conclusively established or estab-

lished as a matter of law. *Jordan v. Ortho Pharmaceuticals, Inc.*, 696 S.W.2d 228, 235 (Tex. App.—San Antonio 1985, no writ); *Pouncy v. Garner*, 626 S.W.2d 337 (Tex. App.—Tyler 1981, writ ref'd n.r.e.). When reviewing "matter of law" points, the Court should consider all of the evidence, and if the converse of the jury's findings is established conclusively, the point will be sustained. Calvert, *supra* p. 42; *Jordan*, 696 S.W.2d at 235.

Here, Lively conclusively established that Valero failed to take or pay for a quantity of gas equal to the Daily Contract Quantity in each of the Contract Years involved. The only evidence in the record to support the finding that Valero did not fail to take or pay for the required amount was presented, over objection, in Defendant's Exhibits 78 and 91. Those exhibits are based entirely upon Valero's contention that the Gas Market Demand Rule abrogates Valero's obligations under the contract. As heretofore shown, Valero's contention is incorrect as a matter of law.

Therefore, the only legally sufficient evidence presented to the jury concerning Valero's failure to take or pay for a quantity of gas equal to the Daily Contract Quantity proves that Valero did fail to take or pay for that quantity of gas as required by the contract during each of the Contract Years involved.

POINTS OF ERROR 12-13. IN SUMMARY: THE COURT OF APPEALS' ACTION IN APPLYING THE TEXAS GAS MARKET DEMAND RULE SO AS TO RELIEVE VALERO OF ITS TAKE-OR-PAY OBLIGATIONS AND LIABILITY UNDER THE CONTRACT IS INVALID, BECAUSE THE TEXAS GAS MARKET DEMAND RULE AS APPLIED BY THE COURT IS PRE-EMPTED BY THE NATURAL GAS POLICY ACT AND VIOLATES THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION.

The Court of Appeals' action in applying the Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid because the Gas Market Demand Rule as applied by the Court is pre-empted by the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301 *et seq.*, and violates the Commerce Clause of the United States Constitution, U.S. CONST. art I, § 8, cl. 3.

In 1978, Congress passed the NGPA, which "has been justly described as 'a comprehensive statute to govern future natural gas regulation.'" *Public Service Commission of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983). As stated by the United States Supreme Court in *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409, 421 (1986) ("*Transco*"):

> [T]he NGPA reflects a congressional belief that a new system of natural gas pricing was needed to balance supply and demand. See S Rep No. 95-436, at 10. The new federal role is to "overse[e] a *national market price regulatory scheme*." Haase, 16 Houston L Rev. at 1079; see S Rep No. 95-436, at

> 21 (NGPA implements "a new commodity value pricing approach"). The NGPA therefore does not constitute a federal retreat from a comprehensive gas policy. Indeed, *the NGPA in some respects expanded federal control, since it granted FERC jurisdiction over the intrastate market for the first time.* See the Act's §§ 311 and 312, 15 U.S.C. §§ 3371 and 3372.

In *Transco,* the Supreme Court held that a ratable take order requiring gas purchasers to purchase gas without discrimination in favor of one producer against another in the same source of supply is pre-empted by the Natural Gas Act and the NGPA. In view of that holding, the Court stated that "we need not reach the question of whether, absent federal occupation of the field, Mississippi's action would nevertheless run afoul of the Commerce Clause." *Id.* at 425. The Court said that "Mississippi's action directly undermines Congress' determination that the supply, the demand and the price of high-cost gas be determined by market forces." *Id.* at 422. The Court stated further:

> *In light of the NGPA's unification of the interstate and intrastate markets, the contention that Congress meant to permit the States to impose inconsistent regulations is especially unavailing.* Second, Mississippi's order would have the effect of increasing the ultimate price to consumers. *Take-or-pay provisions are standard industrywide.* See Pierce, 68 Va L Rev, at 77-78; H R Rep No. 98-814, pp. 23-25, 133-134 (1984). *Pipelines are already committed to purchase gas in excess of market demand.* Mississippi's rule will require Transco to take delivery of noncontract gas; this will lead Transco not to take delivery of contract gas elsewhere, *thus triggering take-or-pay provisions.*

Id. at 423. The Court thus recognized the validity of take-or-pay provisions of gas contracts where pipelines are committed to purchase gas in excess of market demand.

Following the Supreme Court's holding in *Transco,* the United States District Court, Southern District of Texas, Houston Division, in *McGolarick Oil Company, et al v. United Gas Pipe Line Company,* Civil Action No. H-84-4971, by order of September 17, 1987, held:[14]

> The Texas Gas Market Demand Rule, governing ratable production, is preempted under *Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi,* ____U.S.____, 106 S. Ct. 709 (1986). Although states may regulate the production of natural resources in order to achieve a statewide public benefit, such as conservation, *the Texas rule is relied on by United solely to free itself of a contractual obligation. If the rule were enforced to free pipelines of their obligations under take-or-pay contracts, its effect would be contrary to the public interest sought to be served by the federal regulation: gas prices would remain high in spite of an oversupply.*

In a Memorandum on Denial of Modification of the above order,[15] that Court stated as follows:

> United Gas Pipe Line's motion to modify the order of September 17, 1987, will be denied. The September order modified an earlier June memorandum, making is consistent with Transcontinental Gas Pipe Line Corporation v. State Oil and Gas Board of Mississippi, ____U.S.____, 106 S. Ct. 709 (1986).

14. Appendix at A55.

15. Appendix at A58.

Had United wanted to limit its takes of gas under its contract with McGoldrick during periods when gas was in surplus supply, it could have negotiated a market out clause. The contract was drafted by sophisticated attorneys for clients with substantial experience in gas production and marketing. *Allegations that United in good faith believed that the contract's incorporation of the Texas Gas Market Demand Rule was to work as a substitute for a market out clause which could be invoked when the price and demand for gas dropped are disingenuous.* United signed a contract for mandatory minimum purchases of gas during a time of inflated gas prices, gambling that the economy would remain favorable to suppliers. Even if United lacked the capacity immediately to take and resell McGoldrick's gas, it was not commercially impracticable for United to pay for the gas, as it was contractually obligated to do.

The court's September order did not invalidate the Texas ratable production scheme. As Transco has instructed, the statute remains enforceable to achieve certain state goals such as preservation of resources, protection of correlative rights, and waste prevention. Congress' intent to move toward a less-regulated national gas market cannot be interpreted as an invitation to the states to impose additional regulations. Transco at 717. The Texas Gas Market Demand Rule, as applied to purchasers such as United, is preempted, 106 S. Ct. at 718.

In *ANR Pipeline Co. v. Corporation Commission of Oklahoma,* 643 F.Supp. 419 (W.D. Okla. 1986), the Court held the Oklahoma statute and the Oklahoma Corporation Commission Rule 1-305 to be "*unconstitutional as applied to the plaintiffs*" in that case. *Id.* at 424. That statute and rule, like the Texas Gas Market Demand

Rule, provides for ratable purchases of gas by pipelines from a common source of supply on a systemwide basis and establishes a priority schedule for the purchase of gas when production exceeds that purchaser's market demand.

In *Schneidelwind v. ANR Pipeline Co.,* 56 U.S.L.W. 4249 (March 22, 1988), the United States Supreme Court held that a Michigan statute "regulates in a field the NGA has occupied to the exclusion of state law, and that it is therefore preempted." *Id.* at 4251. The statute required a public utility exercising or claiming the right to transport natural gas for public use to obtain approval from the Michigan Public Service Commission before issuing long term securities. Referring to the "comprehensive scheme of federal regulation" in the Natural Gas Act, the Court stated that "while the NGA does not expressly grant FERC preissuance authority over the securities of natural gas companies, FERC achieves the regulatory ends of such review with regard to rates and facilities through the exercise of its express regulatory responsibilities." *Id.* at 4254. In view of its conclusion that the Michigan statute "is pre-empted by the NGA," the Court stated that "we need not decide whether, absent federal occupation of the field, Act 144 violates the Commerce Clause. *See Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Bd. of Mississippi,* 474 U.S. 409, 425 (1986)." *Id.* at 4254.

As recognized in *Transco,* the NGPA resulted in "unification of the interstate and intrastate markets," and now there is a "national natural gas market." 474 U.S. at 423-424. That this is the case is further evidenced by the fact that Section 105 of the NGPA covers "sales under existing *intrastate* contracts."

The authority given by the NGPA to FERC to regulate the price of "all first sales of natural gas irrespective of its interstate or intrastate character" was upheld in *State of Oklahoma v. Federal Energy Regulatory Commission,* 661 F.2d 832 (10th Cir. 1981), *cert. denied,* 457 U.S. 1105 (1982). The Court there held that "the enactment of the NGPA is a constitutionally acceptable exercise of Congress' Commerce Clause power." 661 F.2d at 838. The basis of the Court's holding, among other things, was that Congress may regulate wholly intrastate activities which have "a substantial economic effect on interstate commerce or when the intrastate activity is necessary to effectuate the interstate regulation"; "Congress had a rational basis for determining that the unregulated intrastate market imposed a burden on interstate commerce"; and "Congress may preempt state conservation regulations which interfere with or burden interstate commerce." *Id.* at 834-835.

In considering the validity of state ratable take rules such as the Texas Gas Market Demand Rule, there is no longer any valid reason for differentiating between interstate and intrastate pipelines Both pipelines purchase from the same producers, the same fields, and even the same wells, and the maximum price of the first sales to them is regulated by FERC irrespective of the destination of the gas. Therefore, the Texas Gas Market Demand Rule as applied by the Court of Appeals is not only pre-empted by the NGPA but also runs afoul of and violates the Commerce Clause of the United States Constitution.

Even if, as Valero contends, the definition of "Deliverability" in Article I(j) of the contract can be construed

as limiting Valero's takes of gas to its market demand under the Gas Market Demand Rule, that portion of the agreement would be unenforceable here since during the Contract Years in question the Gas Market Demand Rule as so applied by the Court of Appeals is pre-empted by the NGPA and violates the Commerce Clause. "Parties, by contract, cannot impair the validity of a law, nor control or limit the provisions of a statute." *McFarland v. Haby,* 589 S.W.2d 521, 524 (Tex. Civ. App.—Austin 1979, writ ref'd n.r.e.); *Gorman v. Gause,* 565 S.W.2d 855 (Tex. Comm'n App. 1933, judgmt adopted).

The Gas Market Demand Rule need not be, and was not intended by the Railroad Commission to be, applied in the manner applied by Valero and the Court of Appeals. The proper application of that rule, by holding that it does not relieve a gas purchaser of its alternative obligation under the take-or-pay provision of a gas contract to pay for the minimum quantity of gas it agreed to take, not only is in accord with the Railroad Commission's intention in promulgating the rule but also avoids the rule being pre-empted by the NGPA and being violative of the Commerce Clause of the United States Constitution.

CONCLUSION

The Court of Appeals clearly erred in the respects set forth in the above Points of Error. For the reasons stated, the Supreme Court of Texas should grant the application for writ of error and reverse the judgment of the Court of Appeals and of the Trial Court and take other action as requested in the Prayer for Relief.

PRAYER FOR RELIEF

Petitioners respectfully request that this Court reverse the judgment of the Court of Appeals for the Fourth Supreme Judicial District of Texas and of the Trial Court that Lively take nothing by way of their take-or-pay cause of action, render judgment that Valero is liable to Lively for its failure to pay for the Daily Contract Quantity under the contract for the Contract Years 1982, 1983, 1984, and 1985, remand the case for a new trial as to the amount owed to Lively by Valero, in all other respects affirm the Trial Court's judgment, and grant Petitioners Lively such other and further relief to which they may be justly entitled, including the taxing of the costs to the Respondent.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that Petitioners' Application for Writ of Error was served on the Respondent by mailing a true copy to its attorney by certified mail, return receipt requested, by depositing it, postpaid, in an official depository under the care and custody of the United States Postal Service on the 15th day of June, 1988, enclosed in a wrapper addressed as follows:

J. Clifford Gunter, III
Bracewell & Patterson
2900 South Tower Pennzoil Place
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/s/ JESSE P. LUTON, JR.
Jesse P. Luton, Jr.

No. C-7676

IN THE
SUPREME COURT OF TEXAS
AUSTIN, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Petitioners,

v.

VALERO TRANSMISSION COMPANY,
Respondent.

MOTION FOR REHEARING

To The Honorable Supreme Court Of Texas:

Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley, Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H.B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters, and Theodore L. Wilkinson (collectively referred to as "Lively" or "Petitioners"), Petitioners in this cause, make this Motion for Rehearing, and in support thereof show:

I.

On the 7th day of June, 1989, this Court denied Petitioners' Application for Writ of Error in this cause.

II.

This Court erred in not granting the Application for Writ of Error upon Points of Error 1 and 2, which read:

> POINT 1. The Court of Appeals erred in holding that the Texas Gas Market Demand Rule applies in determining the obligations of Valero under the take-or-pay provision of the contract.
>
> POINT 2. The Court of Appeals erred in holding that the Texas Gas Market Demand Rule was relevant and material to prove or disprove that there was a breach of the "take-or-pay" provision of the contract as alleged by Lively.

The Court of Appeals held that the Gas Market Demand Rule applies so as to relieve Valero Transmission Company ("Valero") of its obligations under the "take-or-pay" provision of the natural gas contract. *Lively Exploration Co. v. Valero Transmission Co.*, 751 S.W.2d 649 (Tex. App.—San Antonio 1988, writ denied). The court based its opinion upon the provisions of the contract, including Article XIII, paragraph 13.1, making the agreement "subject to all valid applicable federal and state laws or city ordinances, and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction." *Id.* at 656.

The above-quoted government regulation clause is a standard provision in natural gas contracts. However, even if this provision were not in the contract, these laws and regulations would become a part of the contract

and govern the transaction. *Wesseley Energy Corp. v. Jennings,* 736 S.W.2d 624 (Tex. 1987); *Langever v. Miller,* 124 Tex. 80, 76 S.W.2d 1025 (1934).

Therefore, the effect of the Court of Appeals' reliance upon the government regulation clause is to hold that the Gas Market Demand Rule relieves *all* pipeline purchasers in Texas of their take-or-pay obligations under *all* of their natural gas contracts in the absence of an express provision to the contrary. This application of the Gas Market Demand Rule is contrary to the clear intention of the Texas Railroad Commission in promulgating that rule and to many rulings of courts in Texas and other states that contractual obligations to pay for gas are not superseded or abrogated by the Gas Market Demand Rule.[1]

This is the first time a Texas court has made such a holding, and its ramifications are far reaching and will have a serious adverse effect on gas producers in this state.

Since the Court of Appeals' opinion, Valero and other natural gas pipeline purchasers have sought to apply that opinion in the manner set forth above so as to relieve them of any obligations under take-or-pay provisions in their gas purchase contracts. This is shown by Exhibit A, pp. 37-38, to the Response of Amici Curiae Cardwell & Hart to Respondent's Reply filed in this Court, in which Valero argued in another case that the Court of Appeals' opinion in this case "conclusively validates" the defense that the Gas Market Demand Rule "obviates" the take-or-pay obligations in gas purchase contracts.

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1. *See* Application for Writ of Error, pp. 14-24.

Therefore, the opinion of the Court of Appeals and this Court's denial of Petitioners' Application for Writ of Error already have resulted, and will continue to result, in reliance by pipeline companies on the Texas Gas Market Demand Rule as a complete defense to liability under take-or-pay provisions of natural gas contracts.[2]

As shown by the cases discussed in the Application for Writ of Error (pp. 17-24) and in the several amicus curiae briefs filed in support of the application, the trial court and the Court of Appeals erred in failing to hold *as a matter of law* that Valero is not relieved of liability under the take-or-pay provision of this contract by the application of the Gas Market Demand Rule. This Court's denial of the Application for Writ of Error effectively affirms that error and changes or so confuses the law in this state as to leave in doubt the validity of virtually every take-or-pay claim by producers against pipelines under natural gas contracts in this state.

This issue is far too important and involves far too many claims under natural gas contracts totaling hundreds of millions of dollars to leave the situation in the

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2. In the San Antonio Express-News, June 9, 1989, at 2-B, col. 1, Valero is reported as saying that the "appellate court's decision upheld Valero's defense that compliance with the market demand and ratable take rules of the Texas Railroad Commission can eliminate liability under the take-or-pay provisions contained in many intrastate gas purchase contracts." Bill Greehey, Chairman and Chief Executive Officer of Valero Energy Corp., is quoted in that same article as saying that "the action of the Texas Supreme Court in upholding our defenses in the Lively case will help us to bring about successful resolution of the few take-or-pay claims which remain outstanding." That article also states that Greg Wright, a Valero spokesman, "said about $60 million in take-or-pay claims are still pending against Valero."

clouded condition it now is in as a result of the Court of Appeals opinion and this Court's denial of the Application for Writ of Error with the notation, Writ Denied.

III.

The Court erred in not granting the Application for Writ of Error upon Points of Error 12 and 13, which read:

> POINT 12. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals is pre-empted by the Natural Gas Policy Act.
>
> POINT 13. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals violates the Commerce Clause of the United States Constitution.

The Gas Market Demand Rule (D. Ex. 7) requires pipeline companies to limit their purchases of gas from producers to each pipeline company's downstream market demand and to "ratably apportion" its purchases "so that takes from various gas producing properties shall be made without discrimination" among producers in the same field "and without unjust or unreasonable discrimination as between fields." (S.F. IX, 1516-1518). The Gas Market Demand Rule does not distinguish between interstate and intrastate pipeline companies.

The Court of Appeals applied the Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations

and liability under its contract with Lively. The Gas Market Demand Rule as applied by that court is preempted by the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301, *et. seq.*, and violates the Commerce Clause of the United States Constitution, U.S. Const. art. I, § 8, cl. 3. *See Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409 (1986) ("*Transco*"), and *ANR Pipeline Co. v. Corporation Commission of the State of Oklahoma*, 860 F.2d 1571 (10th Cir. 1988), *cert. denied*, 57 U.S.L.W. 3719 (U.S. May 2, 1989) (No. 88-1482). *See also Schneidewind v. ANR Pipeline Co.*, 485 U.S. ___, 99 L.Ed.2d 316 (1988).

In 1978, Congress passed the NGPA, which "has been justly described as 'a comprehensive statute to govern future, natural gas regulation.' Note, Legislative History of the Natural Gas Policy Act, 59 Texas L. Rev. 101, 116 (1980)." *Public Service Commission of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 332 (1983). As stated in the Texas Law Review note from which the United States Supreme Court quoted in the above case: "Congress also recognized the need to eliminate the distinction between the interstate and intrastate markets. Because the regulation-free intrastate market had imposed an opportunity cost on the interstate supply, Congress imposed price controls on intrastate gas in sections 105 and 106(b)." 59 Tex. L. Rev. at 120.

The authority given by the NGPA to FERC to regulate the price of "all first sales of natural gas irrespective of its interstate or intrastate character" was upheld in *State of Oklahoma v. Federal Energy Regulatory Com-*

mission, 661 F.2d 832 (10th Cir. 1981), *cert. denied*, 457 U.S. 1105 (1982). The Court there held that "the enactment of the NGPA is a constitutionally acceptable exercise of Congress' Commerce Clause power." 661 F.2d at 838. The basis of the Court's holding, among other things, was that Congress may regulate wholly intrastate activities which have "a substantial economic effect on interstate commerce or when the intrastate activity is necessary to effectuate the interstate regulation"; "Congress had a rational basis for determining that the unregulated intrastate market imposed a burden on interstate commerce"; and "Congress may pre-empt state conservation regulations which interfere with or burden interstate commerce." *Id.* at 834-835.

A Mississippi ratable-take rule requiring, like the Texas Gas Market Demand Rule, that pipelines purchase gas without discrimination in favor of one producer against another in the same source of supply was held to be preempted by the NGPA in *Transcontinental Gas Pine Line Corp. v. State Oil and Gas Board of Mississippi, supra.* There, the Court stated:

> [T]he NGPA reflects a congressional belief that a new system of natural gas pricing was needed to balance supply and demand. See S Rep. No. 95-436, at 10. The new federal role is to "overse[e] a *national market price regulatory scheme.*" Haase, 16 Houston L. Rev, at 1079; see S Rep No. 95-436, at 21 (NGPA implements "a new commodity value pricing approach"). The NGPA therefore does not constitute a federal retreat from a comprehensive gas policy. Indeed, *the NGPA in some respects expanded federal control, since it granted FERC jurisdiction over the intrastate market for the first*

> *time*. See the Act's §§ 311 and 312, 15 USC §§ 3371 and 3372.[3]

Id. at 421. The Court stated further:

> *In light of the NGPA's unification of the interstate and intrastate markets, the contention that Congress meant to permit the States to impose inconsistent regulations is especially unavailing. Second, Mississippi's order would have the effect of increasing the ultimate price to consumers. Take-or-pay provisions are standard industrywide.* See Pierce, 68 Va L Rev, at 77-78; H R Rep No. 98-814, pp 23-25, 133-134 (1984). *Pipelines are already committed to purchase gas in excess of market demand.* Mississippi's rule will require Transco to take delivery of noncontract gas; this will lead Transco not to take delivery of contract gas elsewhere, *thus triggering take-or-pay provisions.*

Id. at 423. The Court declared that "the federal scheme" under the NGPA was "disrupted" by Mississippi's rule. *Id.* at 423-424. In concluding that "Mississippi's ratable-take order is pre-empted," the Court said:

> Mississippi's actions threaten to distort the market once again by artificaliy increasing supply and price. Although, in the long run, producers and pipelines may be able to adjust their selling and purchasing patterns to take account of ratable-take orders, requiring such future adjustments in an industry where long-term contracts are the norm will postpone achievement of Congress' aims in enacting the NGPA.

Id. at 424-425.

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3. Emphasis added throughout except where indicated otherwise.

ANR Pipeline Co. v. Corporation Commission of the State of Oklahoma, supra, involved an Oklahoma statute and rule which, like the Texas Gas Market Demand Rule, required "every purchaser of natural gas to purchase all of the natural gas offered for sale from a common reservoir (without discrimination in favor of one producer as against another, or in favor of one source of supply as against another), and, if the purchaser is unable to do so, then it must purchase natural gas from each producer ratably." 860 F.2d at 1581. The Court held that "all state regulation of the *purchasing or taking* of natural gas by interstate pipeline companies has been pre-empted by the federal regulations contained in the Natural Gas Act and the Natural Gas Policy Act of 1978."[4] *Id.* at 1581. The Court concluded that the Oklahoma statute and rule "interfere with federal regulation of the purchase of natural gas" and "are pre-empted because they create an obstacle to full compliance with the objections of the federal regulation." *Id.* at 1582.

The recent opinion in *Northwest Central Pipeline Corp. v. State Corporation Commission of Kansas,* 498 U.S. ____, 103 L.Ed.2d 509 (1989), does not detract from the holdings in *Transco* and *ANR Pipeline.* The Court in *Northwest* found that Congress had not occupied the field in which the Kansas regulation there involved operates. That regulation provides for the permanent cancellation of producers' underages in the Hugoton Field. It is not directed at pipelines but "to the behavior of gas producers, and regulates their rates of production as a means of exercising traditional state control over the conservation of natural resources and the protection of correlative rights." 103 L.Ed.2d at 529.

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4. Court's emphasis.

The effect of the Texas Gas Market Demand Rule is no different from the statutes and regulations which were held to be preempted in *Transco* and *ANR Pipeline*. Like the Mississippi rule in *Transco* and the Oklahoma statute and rule in *ANR Pipeline*, the Texas Gas Market Demand Rule is directed at the "purchasing or taking" of pipeline companies, disrupts the "federal scheme" under the NGPA, and will "postpone achievement of Congress' aims in enacting the NGPA."

Although the pipelines involved in *Transco* and *ANR Pipeline* were interstate pipelines, the rationale of the opinions in those cases applies equally to intrastate pipelines. Therefore, the fact that Valero is an intrastate pipeline does not preclude a holding in this case that under *Transco* and *ANR Pipeline* the Texas Gas Market Demand Rule is preempted.

The elimination by Congress in the NGPA of "the distinction between the interstate and intrastate markets," with the resulting "unification of the interstate and intrastate markets" and "a national market price regulatory scheme" constitutes a recognition by Congress that the interstate and intrastate markets are inseparable. What is done in one market has an impact and effect on the other. The same is true as to interstate and intrastate pipeline purchasers. Interstate and intrastate pipelines compete for the same gas and purchase gas from the same producers, the same fields, and even the same wells, and the maximum price of the first sale to them is regulated by FERC irrespective of the destination of the gas. Their purchasing practices and other actions have a definite impact upon each other and upon both the interstate and intrastate markets.

The Texas Gas Market Demand Rule affects contracts and actions of all pipeline purchasers in Texas, both interstate and intrastate. The rule is preempted by the NGPA and also runs afoul of and violates the Commerce Clause of the United States Constitution. Therefore, the Court of Appeals' application of that rule in this case so as to relieve Valero of its obligations and liabilities under the take-or-pay provision of its contract with Lively is invalid as a matter of law and should be reversed.

WHEREFORE, Petitioners Lively Exploration Company, et al., request that the Court grant this motion and that the Application for Writ of Error in this cause be granted.

Respectfully submitted,

SCOTT, DOUGLASS & LUTON

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CERTIFICATE OF SERVICE

I hereby certify that Petitioners' Motion for Rehearing was served on the Respondent by mailing a true copy to its attorney by certified mail, return receipt requested, by depositing it, postpaid, in an official depository under the care and custody of the United States Postal Service on the 21st day of June, 1989, enclosed in a wrapper addressed as follows:

Mr. J. Clifford Gunter, III
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NATURAL GAS ACT OF 1938
15 U.S.C. §§ 717-717w (1988)

§ 717. Regulation of natural gas companies

(a) Necessity of regulation in public interest

As disclosed in reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

(b) Transactions to which provisions of chapter applicable

The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

(c) Intrastate transactions exempt from provisions of chapter; certification from State commission as conclusive evidence

The provisions of this chapter shall not apply to any person engaged in or legally authorized to engage in

t' 'ransportation in interstate commerce or the sale in interstate commerce for resale of natural gas received by such person from another person within or at the boundary of a State if all the natural gas so received is ultimately consumed within such State, or to any facilities used by such person for such transportation or sale, provided that the rates and service of such person and facilities be subject to regulation by a State commission. The matters exempted from the provisions of this chapter by this subsection are declared to be matters primarily of local concern and subject to regulation by the several States. A certification from such State commission to the Federal Power Commission that such State commission has regulatory jurisdiction over rates and service of such person and facilities and is exercising such jurisdiction shall constitute conclusive evidence of such regulatory power of jurisdiction.

§ 717a. Definitions

When used in this chapter, unless the context otherwise requires—

(1) "Person" includes an individual or a corporation.

(2) "Corporation" includes any corporation, joint-stock company, partnership, association, business trust, organized group of persons, whether incorporated or not, receiver or receivers, trustee or trustees of any of the foregoing, but shall not include municipalities as hereinafter defined.

(3) "Municipality" means a city, county, or other political subdivision or agency of a State.

(4) "State" means a State admitted to the Union, the District of Columbia, and any organized Territory of the United States.

(5) "Natural gas" means either natural gas unmixed, or any mixture of natural and artificial gas.

(6) "Natural-gas company" means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.

(7) "Interstate commerce" means commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commerce takes place within the United States.

(8) "State commission" means the regulatory body of the State or municipality having jurisdiction to regulate rates and charges for the sale of natural gas to consumers within the State or municipality.

(9) "Commission" and "Commissioner" means the Federal Power Commission, and a member thereof, respectively.

§ 717b. Exportation or importation of natural gas

After six months from June 21, 1938, no person shall export any natural gas from the United States to a foreign country or import any natural gas from a foreign country without first having secured an order of the Commission authorizing it to do so. The Commission shall issue such order upon application, unless, after

opportunity for hearing, it finds that the proposed exportation or importation will not be consistent with the public interest. The Commission may by its order grant such application, in whole or in part, with such modification and upon such terms and conditions as the Commission may find necessary or appropriate, and may from time to time, after opportunity for hearing, and for good cause shown, make such supplemental order in the premises as it may find necessary or appropriate.

§ 717c. Rates and charges

(a) Just and reasonable rates and charges

All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

(b) Undue preferences and unreasonable rates and charges prohibited

No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Filing of rates and charges with Commission; public inspection of schedules

Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from June 21, 1938) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Changes in rates and charges; notice to Commission

Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Authority of Commission to hold hearings concerning new schedule of rates

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts

received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

§ 717d. Fixing rates and charges; determination of cost of production or transportation

(a) Decreases in rates

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas com-

pany on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) Costs of production and transportation

The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

§ 717e. Ascertainment of cost of property

(a) Cost of property

The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

(b) Inventory of property; statement of costs

Every natural-gas company upon request shall file with the Commission an inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the Commission informed regarding the cost of all additions, betterments, extensions, and new construction.

§ 717f. Construction, extension, or abandonment of facilities

(a) Extension or improvement of facilities on order of court; notice and hearing.

Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby. *Provided,* That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers.

(b) Abandonment of facilities or services; approval of Commission

No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of

natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c) Certificate of public convenience and necessity

(1)(A) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations; *Provided*, however, That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be lawful.

(B) In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application

shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(2) The Commission may issue a certificate of public convenience and necessity to a natural-gas company for the transportation in interstate commerce of natural gas used by any person for one or more high-priority uses, as defined, by rule, by the Commission, in the case of—

(A) natural gas sold by the producer to such person; and

(B) natural gas produced by such person.

(d) Application for certificate of public convenience and necessity

Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form, contain such information, and notice thereof shall be served upon such interested parties and in such manner as the Commission shall, by regulation require.

(e) Granting of certificate of public convenience and necessity

Except in the cases governed by the provisos contained in subsection (c)(1) of this section, a certificate shall be

issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

(f) Determination of service area; jurisdiction of transportation to ultimate consumers

(1) The Commission, after a hearing had upon its own motion or upon application, may determine the service area to which each authorization under this section is to be limited. Within such service area as determined by the Commission a natural-gas company may enlarge or extend its facilities for the purpose of supplying increased market demands in such service area without further authorization; and

(2) If the Commission has determined a service area pursuant to this subsection, transportation to ultimate consumers in such service area by the holder of such service area determination, even if across State lines, shall be subject to the exclusive jurisdiction of the State commission in the State in which the gas is consumed. This sec-

tion shall not apply to the transportation of natural gas to another natural gas company.

(g) Certificate of public convenience and necessity for service of area already being served

Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural-gas company.

(h) Right of eminent domain for construction of pipelines, etc.

When any holder of a certificate of public convenience and necessity cannot acquire by contract, or is unable to agree with the owner of property to the compensation to be paid for, the necessary right-of-way to construct, operate, and maintain a pipe line or pipe lines for the transportation of natural gas, and the necessary land or other property, in addition to right-of-way, for the location of compressor stations, pressure apparatus, or other stations or equipment necessary to the proper operation of such pipe line or pipe lines, it may acquire the same by the exercise of the right of eminent domain in the district court of the United States for the district in which such property may be located, or in the State courts. The practice and procedure in any action or proceeding for that purpose in the district court of the United States shall conform as nearly as may be with the practice and procedure in similar action or proceeding in the courts of the State where the property is situated: *Provided*, That the United States district courts shall only have jurisdiction of cases when the amount claimed by the owner of the property to be condemned exceeds $3,000.

§ 717g. Accounts; records; memoranda

(a) Rules and regulations for keeping and preserving accounts, records, etc.

Every natural-gas company shall make, keep, and preserve for such periods, such accounts, records of cost-accounting procedures, correspondence, memoranda, papers, books, and other records as the Commission may by rules and regulations prescribe as necessary or appropriate for purposes of the administration of this chapter: *Provided, however,* That nothing in this chapter shall relieve any such natural-gas company from keeping any accounts, memoranda, or records which such natural-gas company may be required to keep by or under authority of the laws of any State. The Commission may prescribe a system of accounts to be kept by such natural-gas companies, and may classify such natural-gas companies and prescribe a system of accounts for each class. The Commission, after notice and opportunity for hearing, may determine by order the accounts in which particular outlays or receipts shall be entered, charged, or credited. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry, and the Commission may suspend a charge or credit pending submission of satisfactory proof in support thereof.

(b) Access to and inspection of accounts and records

The Commission shall at all times have access to and the right to inspect and examine all accounts, records, and memoranda of natural-gas companies; and it shall be the duty of such natural-gas companies to furnish to the Commission, within such reasonable time as the Com-

mission may order, any information with respect thereto which the Commission may by order require, including copies of maps, contracts, reports of engineers, and other data, records, and papers, and to grant to all agents of the Commission free access to its property and its accounts, records, and memoranda when requested so to do. No member, officer, or employee of the Commission shall divulge any fact or information which may come to his knowledge during the course of examination of books, records, data, or accounts, except insofar as he may be directed by the Commission or by a court.

(c) Books, accounts, etc., of the person controlling gas company subject to examination

The books, accounts, memoranda, and records of any person who controls directly or indirectly a natural-gas company subject to the jurisdiction of the Commission and of any other company controlled by such person, insofar as they relate to transactions with or the business of such natural-gas company, shall be subject to examination on the order of the Commission.

§ 717h. Rates of depreciation

(a) Depreciation and amortization

The Commission may, after hearing, require natural-gas companies to carry proper and adequate depreciation and amortization accounts in accordance with such rules, regulations, and forms of account as the Commission may prescribe. The Commission may from time to time ascertain and determine, and by order fix, the proper and adequate rates of depreciation and amortization of the several classes of property of each natural gas company

used or useful in the production, transportation, or sale of natural gas. Each natural-gas company shall conform its depreciation and amortization accounts to the rates so ascertained, determined, and fixed. No natural-gas company subject to the jurisdiction of the Commission shall charge to operating expenses any depreciation or amortization charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation or amortization other than that prescribed therefor by the Commission. No such natural-gas company shall in any case include in any form under its operating or other expenses any depreciation, amortization, or other charge or expenditure included elsewhere as a depreciation or amortization charge or otherwise under its operating or other expenses. Nothing in this section shall limit the power of a State commission to determine in the exercise of its jurisdiction, with respect to any natural-gas company, the percentage rates of depreciation or amortization to be allowed, as to any class of property of such natural-gas company, or the composite depreciation or amortization rate, for the purpose of determining rates or charges.

(b) Rules

The Commission, before prescribing any rules or requirements as to accounts, records, or memoranda, or as to depreciation or amortization rates, shall notify each State commission having jurisdiction with respect to any natural-gas company involved and shall give reasonable opportunity to each such commission to present its views and shall receive and consider such views and recommendations.

§ 717i. Periodic and special reports

(a) Form and contents of reports

Every natural-gas company shall file with the Commission such annual and other periodic or special reports as the Commission may by rules and regulations or order prescribe as necessary or appropriate to assist the Commission in the proper administration of this chapter. The Commission may prescribe the manner and form in which such reports shall be made, and require from such natural-gas companies specific answers to all questions upon which the Commission may need information. The Commission may require that such reports shall include, among other things, full information as to assets and liabilities, capitalization, investment and reduction thereof, gross receipts, interest due and paid, depreciation, amortization, and other reserves, cost of facilities, cost of maintenance and operation of facilities for the production, transportation, or sale of natural gas, cost of renewal and replacement of such facilities, transportation, delivery, use, and sale of natural gas. The Commission may require any such natural-gas company to make adequate provision for currently determining such costs and other facts. Such reports shall be made under oath unless the Commission otherwise specifies.

(b) Unlawful conduct

It shall be unlawful for any natural-gas company willfully to hinder, delay, or obstruct the making, filing, or keeping of any information, document, report, memorandum, record, or account required to be made, filed, or kept under this chapter or any rule, regulation, or order thereunder.

§ 717j. State compacts for conservation, transportation, etc., of natural gas

(a) Assembly of pertinent information; report to Congress

In case two or more States propose to the Congress compacts dealing with the conservation, production, transportation, or distribution of natural gas it shall be the duty of the Commission to assemble pertinent information relative to the matters covered in any such proposed compact, to make public and to report to the Congress information so obtained, together with such recommendations for further legislation as may appear to be appropriate or necessary to carry out the purposes of such proposed compact and to aid in the conservation of natural-gas resources within the United States and in the orderly, equitable, and economic production, transportation, and distribution of natural gas.

(b) Assembly of information relative to operation of compact; report to Congress

It shall be the duty of the Commission to assemble and keep current pertinent information relative to the effect and operation of any compact between two or more States heretofore or hereafter approved by the Congress, to make such information public, and to report to the Congress, from time to time, the information so obtained, together with such recommendations as may appear to be appropriate or necessary to promote the purposes of such compact.

(c) Availability of services, etc., of other agencies

In carrying out the purposes of this chapter, the Commission shall, so far as practicable, avail itself of the services, records, reports, and information of the execu-

tive departments and other agencies of the Government, and the President may, from time to time, direct that such services and facilities be made available to the Commission.

§ 717k. Officials dealing in securities

It shall be unlawful for any officer or director of any natural-gas company to receive for his own benefit, directly or indirectly, any money or thing of value in respect to the negotiation, hypothecation, or sale by such natural-gas company of any security issued, or to be issued, by such natural-gas company, or to share in any of the proceeds thereof, or to participate in the making or paying of any dividends, other than liquidating dividends, of such natural-gas company from any funds properly included in capital account.

§ 717*l*. Complaints

Any State, municipality, or State commission complaining of anything done or omitted to be done by any natural-gas company in contravention of the provisions of this chapter may apply to the Commission by petition, which shall briefly state the facts, whereupon a statement of the complaint thus made shall be forwarded by the Commission to such natural-gas company, which shall be called upon to satisfy the complaint or to answer the same in writing within a reasonable time to be specified by the Commission.

§ 717m. Investigations by Commission

(a) Power of Commission

The Commission may investigate any facts, conditions, practices, or matters which it may find necessary or

proper in order to determine whether any person has violated or is about to violate any provisions of this chapter or any rule, regulation, or order thereunder, or to aid in the enforcement of the provisions of this chapter or in prescribing rules or regulations thereunder, or in obtaining information to serve as a basis for recommending further legislation to the Congress. The Commission may permit any person to file with it a statement in writing, under oath or otherwise, as it shall determine, as to any or all facts and circumstances concerning a matter which may be the subject of investigation. The Commission, in its discretion, may publish in the manner authorized by section 825k of title 16, and make available to State commissions and municipalities, information concerning any such matter.

(b) Determination of adequacy of gas reserves

The Commission may, after hearing, determine the adequacy or inadequacy of the gas reserves held or controlled by any natural-gas company, or by anyone on its behalf, including its owned or leased properties or royalty contracts; and may also, after hearing, determine the propriety and reasonableness of the inclusion in operating expenses, capital, or surplus of all delay rentals or other forms of rental or compensation for unoperated lands and leases. For the purpose of such determinations, the Commission may require any natural-gas company to file with the Commission true copies of all its lease and royalty agreements with respect to such gas reserves.

(c) Administration of oaths and affirmations; subpena of witnessse, etc.

For the purpose of any investigation or any other proceeding under this chapter, any member of the Com-

mission, or any officer designated by it, is empowered to administer oaths and affirmations, subpena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, contracts, agreements, or other records which the Commission finds relevant or material to the inquiry Such attendance of witnesses and the production of any such records may be required from any place in the United States or at any designated place of hearing. Witnesses summoned by the Commission to appear before it shall be paid the same fees and mileage that are paid witnesses in the courts of the United States.

(d) Jurisdction of courts of United States

In case of contumacy by, or refusal to obey a subpena issued to, any person, the Commission may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, contracts, agreements, and other records. Such court may issue an order requiring such person to appear before the Commission or member or officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question; and any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district whereof such person is an inhabitant or wherever he may be found or may be doing business. Any person who willfully shall fail or refuse to attend and testify or to answer any

lawful inquiry or to produce books, papers, correspondence, memoranda, contracts, agreements, or other records, if in his or its power so to do, in obedience to the subpena of the Commission, shall be guilty of a misdemeanor and upon conviction shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year, or both.

(e) Testimony of witnesses

The testimony of any witness may be taken at the instance of a party, in any proceeding or investigation pending before the Commission, by deposition at any time after the proceeding is at issue. The Commission may also order testimony to be taken by deposition in any proceeding or investigation pending before it at any stage of such proceeding or investigation. Such depositions may be taken before any person authorized to administer oaths not being of counsel or attorney to either of the parties, nor interested in the proceeding or investigation. Reasonable notice must first be given in writing by the party or his attorney proposing to take such deposition to the opposite party or his attorney of record, as either may be nearest, which notice shall state the name of the witness and the time and place of the taking of his deposition. Any person may be compelled to appear and depose, and to produce documentary evidence, in the same manner as witnesses may be compelled to appear and testify and produce documentary evidence before the Commission, as hereinbefore provided. Such testimony shall be reduced to writing by the person taking deposition, or under his direction, and shall, after it has been reduced to writing, be subscribed by the deponent.

(f) Deposition of witnesses in a foreign country

If a witness whose testimony may be desired to be taken by deposition be in a foreign country, the deposition may be taken before an officer or person designated by the Commission, or agreed upon by the parties by stipulation in writing to be filed with the Commission. All depositions must be promptly filed with the Commission.

(g) Witness fees

Witnesses whose depositions are taken as authorized in this chapter, and the person or officer taking the same, shall be entitled to the same fees as are paid for like services in the courts of the United States.

§ 717n. Hearings; rules of procedure

(a) Hearings; parties

Hearings under this chapter may be held before the Commission, any member or members thereof, or any representative of the Commission designated by it, and appropriate records thereof shall be kept. In any proceeding before it, the Commission in accordance with such rules and regulations as it may prescribe, may admit as a party any interested State, State commission, municipality or any representative of interested consumers or security holders, or any competitor of a party to such proceeding, or any other person whose participation in the proceeding may be in the public interest.

(b) Procedure

All hearings, investigations, and proceedings under this chapter shall be governed by rules of practice and

procedure to be adopted by the Commission, and in the conduct thereof the technical rules of evidence need not be applied. No informality in any hearing, investigation, or proceeding or in the manner of taking testimony shall invalidate any order, decision, rule, or regulation issued under the authority of this chapter.

§ 717o. Administrative powers of Commission; rules, regulations, and orders

The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this chapter. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this chapter; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours.

§ 717p. Joint boards

(a) Reference of matters to joint boards; composition and power

The Commission may refer any matter arising in the administration of this chapter to a board to be composed of a member or members, as determined by the Commission, from the State or each of the States affected or to be affected by such matter. Any such board shall be vested with the same power and be subject to the same duties and liabilities as in the case of a member of the Commission when designated by the Commission to hold any hearings. The action of such board shall have such force and effect and its proceedings shall be conducted in such manner as the Commission shall by regulations prescribe. The Board shall be appointed by the Commission from persons nominated by the State commission of each State affected, or by the Governor of such State if there is no State commission. Each State affected shall be entitled to the same number of representatives on the board unless the nominating power of such State waives such right. The Commission shall have discretion to reject the nominee from any State, but shall thereupon invite a new nomination from that State. The members of a board shall receive such allowances for expenses as the Commission shall provide. The Commission may, when in its discretion sufficient reason exists therefor, revoke any reference to such a board.

(b) Conference with State commissions regarding rate structure, costs, etc.

The Commission may confer with any State commission regarding rate structures, costs, accounts, charges,

practices, classifications, and regulations of natural-gas companies; and the Commission is authorized, under such rules and regulations as it shall prescribe, to hold joint hearings with any State commission in connection with any matter with respect to which the Commission is authorized to act. The Commission is authorized in the administration of this chapter to avail itself of such cooperation, services, records, and facilities as may be afforded by any State commission.

(c) Information and reports available to State commissions

The Commission shall make available to the several State commissions such information and reports as may be of assistance in State regulation of natural-gas companies. Whenever the Commission can do so without prejudice to the efficient and proper conduct of its affairs, it may, upon request from a State commission, make available to such State commission as witnesses any of its trained rate, valuation, or other experts, subject to reimbursement of the compensation and traveling expenses of such witnesses. All sums collected hereunder shall be credited to the appropriation from which the amounts were expended in carrying out the provisions of this subsection.

§ 717q. Appointment of officers and employees

The Commission is authorized to appoint and fix the compensation of such officers, attorneys, examiners, and experts as may be necessary for carrying out its functions under this chapter; and the Commission may, subject to civil-service laws, appoint such other officers and employees as are necessary for carrying out such

functions and fix their salaries in accordance with chapter 51 and subchapter III of chapter 53 of title 5.

§ 717r. Rehearing and review

(a) Application for rehearing; time

Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this chapter to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon. Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b) of this section, the Commission may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this chapter.

(b) Review of Commission order

Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the

court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to

the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which is supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of title 28.

(c) Stay of Commission order

The filing of an application for rehearing under subsection (a) of this section shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

§ 717s. Enforcement of chapter

(a) Action in district court for injunction

Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule, regulation, or order thereunder, it may in its discretion bring an action in the proper district court of the United States, or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this chapter or any rule, regulation, or order there-

under, and upon a proper showing a permanent or temporary injunction or decree or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices or concerning apparent violations of the Federal antitrust laws to the Attorney General, who, in his discretion, may institute the necessary criminal proceedings.

(b) Mandamus

Upon application of the Commission the district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction to issue writs of mandamus commanding any person to comply with the provisions of this chapter or any rule, regulation, or order of the Commission thereunder.

(c) Employment of attorneys by Commission

The Commission may employ such attorneys as it finds necessary for proper legal aid and service of the Commission or its members in the conduct of their work, or for proper representation of the public interest in investigations made by it, or cases or proceedings pending before it, whether at the Commission's own instance or upon complaint, or to appear for or represent the Commission in any case in court; and the expenses of such employment shall be paid out of the appropriation for the Commission.

§ 717t. General penalties

(a) Any person who wilfully and knowingly does or causes or suffers to be done any act, matter, or thing

in this chapter prohibited or declared to be unlawful, or who willfully and knowingly omits or fails to do any act, matter, or thing in this chapter required to be done, or willfully and knowingly causes or suffers such omission or failure, shall, upon conviction thereof, be punished by a fine of not more than $5,000 or by imprisonment for not more than two years, or both.

(b) Any person who willfully and knowingly violates any rule, regulation, restriction, condition, or order made or imposed by the Commission under authority of this chapter, shall, in addition to any other penalties provided by law, be punished upon conviction thereof by a fine of not exceeding $500 for each and every day during which such offense occurs.

§ 717u. Jurisdiction of offenses; enforcement of liabilities and duties

The District Courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules, regulations, and orders thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this chapter or any rule, regulation, or order thereunder. Any criminal proceeding shall be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this chapter or any rule, regulation, or order thereunder may be brought in any such district or in the district wherein the defendant is an inhabitant, and process in such cases may be served

wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, and 1292 of title 28. No costs shall be assessed against the Commission in any judicial proceeding by or against the Commission under this chapter.

§ 717v. Separability of provisions

If any provision of this chapter, or the application of such provision to any person or circumstance, shall be held invalid, the remainder of the chapter, and the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby. (June 21, 1938, ch. 556, § 23, 52 Stat. 833.)

§ 717w. Short title

This chapter may be cited as the "Natural Gas Act."

NATURAL GAS POLICY ACT OF 1978
15 U.S.C. §§ 3301-3432 (1988)

§ 3301. Definitions

For purposes of this chapter—

(1) Natural gas

The term "natural gas" means either natural gas unmixed, or any mixture of natural and artificial gas.

(2) Well

The term "well" means any well for the discovery or production of natural gas, crude oil, or both.

(3) New well

The term "new well" means any well—

(A) the surface drilling of which began on or after February 19, 1977; or

(B) the depth of which was increased, by means of drilling on or after February 19, 1977, to a completion location which is located at least 1,000 feet below the depth of the deepest completion location of such well attained before February 19, 1977.

(4) Old well

The term "old well" means any well other than a new well.

(5) Marker well

(A) General rule

The term "marker well" means any well from

which natural gas was produced in commercial quantities at any time after January 1, 1970, and before April 20, 1977.

(B) New wells

The term "marker well" does not include any new well under paragraph (3)(A) but includes any new well under paragraph (3)(B) if such well qualifies as a marker well under subparagraph (A) of this paragraph.

(6) Reservoir

The term "reservoir" means any producible natural accumulation of natural gas, crude oil, or both, confined—

(A) by impermeable rock or water barriers and characterized by a single natural pressure system; or

(B) by lithologic or structural barriers which prevent pressure communication.

(7) Completion location

(A) General rule

The term "completion location" means any subsurface location from which natural gas is being or has been produced in commercial quantities.

(B) Marker well

The term "completion location", when used with reference to any marker well, means any subsurface location from which natural gas was

produced from such well in commercial quantities after January 1, 1970, and before April 20, 1977.

(8) Proration unit

The term "proration unit" means—

(A) any portion of a reservoir, as designated by the State or Federal agency having regulatory jurisdiction with respect to production from such reservoir, which will be effectively and efficiently drained by a single well;

(B) any drilling unit, production unit, or comparable arrangement, designated or recognized by the State or Federal agency having jurisdiction with respect to production from the reservoir, to describe that portion of such reservoir which will be effectively and efficiently drained by a single well; or

(C) if such portion of a reservoir, unit, or comparable arrangement is not specifically provided for by State law or by any action of any State or Federal agency having regulatory jurisdiction with respect to production from such reservoir, any voluntary unit agreement or other comparable arrangement applied, under local custom or practice within the locale in which such reservoir is situated, for the purpose of describing the portion of a reservoir which may be effectively and efficiently drained by a single well.

(9) New lease

The term "new lease", when used with respect to the Outer Continental Shelf, means a lease,

entered into on or after April 20, 1977, of submerged acreage.

(10) Old lease

The term "old lease", when used with respect to the Outer Continental Shelf, means any lease other than a new lease.

(11) New contract

The term "new contract" means any contract, entered into on or after November 9, 1978, for the first sale of natural gas which was not previously subject to an existing contract.

(12) Rollover contract

The term "rollover contract" means any contract, entered into on or after November 9, 1978, for the first sale of natural gas that was previously subject to an existing contract which expired at the end of a fixed term (not including any extension thereof taking effect on or after November 9, 1978) specified by the provisions of such existing contract, as such contract was in effect on November 9, 1978, whether or not there is an identity of parties or terms with those of such existing contract.

(13) Existing contract

The term "existing contract" means any contract for the first sale of natural gas in effect on November 8, 1978.

(14) Successor to an existing contract

The term "successor to an existing contract" means any contract, other than a rollover contract,

entered into on or after November 9, 1978, for the first sale of natural gas which was previously subject to an existing contract, whether or not there is an identity of parties or terms with those of such existing contract.

(15) Interstate pipeline

The term "interstate pipeline" means any person engaged in natural gas transportation subject to the jurisdiction of the Commission under the Natural Gas Act [15 U.S.C. 717 et seq.].

(16) Intrastate pipeline

The term "intrastate pipeline" means any person engaged in natural gas transportation (not including gathering) which is not subject to the jurisdiction of the Commission under the Natural Gas Act [15 U.S.C. 717 et seq.] (other than any such pipeline which is not subject to the jurisdiction of the Commission solely by reason of section 1(c) of the Natural Gas Act [15 U.S.C. 717(c)]).

(17) Local distribution company

The term "local distribution company" means any person, other than any interstate pipeline or any intrastate pipeline, engaged in the transportation, or local distribution, of natural gas and the sale of natural gas for ultimate consumption.

(18) Committed or dedicated to interstate commerce

(A) General rule

The term "committed or dedicated to interstate commerce", when used with respect to natural gas, means—

(i) natural gas which is from the Outer Continental Shelf; and

(ii) natural gas which, if sold, would be required to be sold in interstate commerce (within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.]) under the terms of any contract, any certificate under the Natural Gas Act, or any provision of such Act.

(B) Exclusion

Such term does not apply with respect to—

(i) natural gas sold in interstate commerce (within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.])—

(I) under section 6 of the Emergency Natural Gas Act of 1977;

(II) under any limited term certificate, granted pursuant to section 7 of the Natural Gas Act [15 U.S.C. 717f], which contains a pregrant of abandonment of service for such natural gas;

(III) under any emergency regulation under the second proviso of section 7(c) of the Natural Gas Act [15 U.S.C. 717f(c)]; or

(IV) to the user by the producer and transported under any certificate, granted pursuant to section 7(c) of the Natural Gas Act [15 U.S.C. 717f(c)], if such certificate was specifically granted for the transportation of that natural gas for such user;

(ii) natural gas for which abandonment of service was granted before November 9, 1978, under section 7 of the Natural Gas Act [15 U.S.C. 717f]; and

(iii) natural gas which, but for this clause, would be committed or dedicated to interstate commerce under subparagraph (A)(ii) by reason of the action of any person (including any successor in interest thereof, other than by means of any reversion of a leasehold interest), if on May 31, 1978—

(I) neither that person nor any affiliate thereof, had any right to explore for, develop, produce, or sell such natural gas; and

(II) such natural gas was not being sold in interstate commerce (within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.]) for resale (other than any sale described in clause (i)(I), (II), or (III)).

(19) Certificated natural gas

The term "certificated natural gas" means natural gas transported by any interstate pipeline in a facility for which there is in effect a certificate issued under section 7(c) of the Natural Gas Act [15 U.S.C. 717f(c)]. Such term does not include natural gas sold to the user by the producer and transported pursuant to a certificate which is specifically issued under section 7(c) of the Natural Gas Act for the transportation of that natural gas, for such user unless such natural gas is used for the generation of electricity.

(20) Sale

The term "sale" means any sale, exchange, or other transfer for value.

(21) First sale

(A) General rule

The term "first sale" means any sale of any volume of natural gas—

(i) to any interstate pipeline or intrastate pipeline;

(ii) to any local distribution company;

(iii) to any person for use by such person;

(iv) which precedes any sale described in clauses (i), (ii), or (iii); and

(v) which precedes or follows any sale described in clauses (i), (ii), (iii), or (iv) and is defined by the Commission as a first sale in order to prevent circumvention of any maximum lawful price established under this chapter.

(B) Certain sales not included

Clauses (i), (ii), (iii), or (iv) of subparagraph (A) shall not include the sale of any volume of natural gas by any interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof, unless such sale is attributable to volumes of natural gas produced by such interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof.

(22) Deliver

The term "deliver", when used with respect to any first sale of natural gas, means the physical delivery from the seller; except that in the case of the sale of proven reserves in place to any interstate pipeline, any intrastate pipeline, any local distribution company, or any user of such natural gas, such term means the transfer of title to such reserves.

(23) Certificate

The term "certificate", when used with respect to the Natural Gas Act [15 U.S.C. 717 et seq.], means a certificate of public convenience and necessity issued under such Act.

(24) Commission

The term "Commission" means the Federal Energy Regulatory Commission.

(25) Federal agency

The term "Federal agency" has the same meaning as given such term in section 105 of title 5.

(26) Person

The term "person" includes the United States, any State, and any political subdivision, agency, or instrumentality of the foregoing.

(27) Affiliate

The term "affiliate", when used in relation to any person, means another person which controls, is controlled by, or is under common control with, such person.

(28) Electric utility

The term "electric utility" means any person to the extent such person is engaged in the business of the generation of electricity and sale, directly or indirectly, of electricity to the public.

(29) Mcf

The term "Mcf", when used with respect to natural gas, means 1,000 cubic feet of natural gas measured at a pressure of 14.73 pounds per square inch (absolute) and a temperature of 60 degrees Fahrenheit.

(30) Btu

The term "Btu" means British thermal unit.

(31) Month

The term "month" means a calendar month.

(32) Mile

The term "mile" means a statute mile of 5,280 feet.

(33) United States

The term "United States" means the several States and includes the Outer Continental Shelf.

(34) State

The term "State" means each of the several States and the District of Columbia.

(35) Outer Continental Shelf

The term "Outer Continental Shelf" has the same meaning as such term has under section 1331(a) of title 43.

(36) Prudhoe Bay Unit of Alaska

The term "Prudhoe Bay Unit of Alaska" means the geographic area subject to the voluntary unit agreement approved by the Commissioner of the Department of Natural Resources of the State of Alaska on June 2, 1977, and referred to as the "affected area" in Conservation Order No. 145 of the Alaska Oil and Gas Conservation Committee, Division of Oil and Gas Conservation, Department of Natural Resources of the State of Alaska, as such order was in effect on June 1, 1977, and determined without regard to any adjustments in the description of the affected area permitted to be made under such order.

(37) Antitrust laws

The term "Federal antitrust laws" means the Sherman Act (15 U.S.C. 1 et seq.), the Clayton Act (15 U.S.C. 12, 13, 14-19, 20, 21, 22-27), the Federal Trade Commission Act (15 U.S.C. 41 et seq.), sections 73 and 74 of the Wilson Tariff Act (15 U.S.C. 8-9), and the Act of June 19, 1936, chapter 592 (15 U.S.C. 13, 13a, 13b, and 21a).

§ 3311. Inflation adjustment; other general price ceiling rules

(a) Annual inflation adjustment factor

(1) General rule

For purposes of this subchapter, the annual inflation adjustment factor applicable for any month shall be the sum of—

(A) a factor equal to one hundredth of the quarterly percent change in the GNP implicit price deflator; plus

(B) a correction factor of 1.002.

(2) Quarterly percent change in the GNP implicit price deflator

For purposes of paragraph (1)—

(A) In general

The term "quarterly percent change in the GNP implicit price deflator", when used with respect to any month, means the quarterly percent change in the GNP implicit price deflator, computed and published as an annual rate by the Department of Commerce, for the most recent calendar quarter for which such quarterly percent change has been so published at least 8 days before the beginning of such month.

(B) Months before enactment

For purposes of applying such term with respect to any month in any calendar quarter which ends before November 9, 1978, and for which a quarterly percent change in the GNP implicit price deflator has been published by the Department of Commerce as of November 9, 1978, the quarterly percent change in the GNP implicit price deflator for the calendar quarter in which such month occurs shall be used in lieu of the quarterly percent change in the GNP implicit price deflator for a preceding calendar quarter.

(3) GNP implicit price deflator

For purposes of paragraph (2)—

(A) In general

The term "GNP implicit price deflator" means, except as provided in subparagraph (B), the preliminary estimate of the implicit price deflator, seasonally adjusted, for the gross national product, as computed and published by the Department of Commerce for the calendar quarter involved.

(B) Most recent data available on November 9, 1978

The most recent revision, if any, of such implicit price deflator which has been so published before November 9, 1978, shall be used in lieu of the preliminary estimate of such implicit price deflator.

(b) Rules of general application

(1) Depth

Except where otherwise provided, the depth of the completion location of any well shall be the true vertical depth, measured from the surface location of the well.

(2) Commercial quantities

In determining whether production of natural gas has occurred in commercial quantities, quantities of natural gas produced from a well and used for the testing of such well or for other field uses which are production related shall not be taken into account.

(3) Computation of monthly equivalent

For purposes of computing any price under this subchapter, the monthly equivalent of any factor shall be the twelfth root of such factor.

(4) Application of ceiling prices

The maximum lawful ceiling prices under this subchapter—

(A) shall only apply to natural gas produced in the United States;

(B) shall apply to the month of delivery without regard to the date of the sale or the date of the contract under which the sale occurs; and

(C) shall not apply to deliveries occurring before the first day of the first month beginning after November 9, 1978.

(5) Sales qualifying under more than one provision

If any natural gas qualifiies under more than one provision of this subchapter providing for any maximum lawful price or for any exemption from such a price with respect to any first sale of such natural gas, the provision which could result in the highest price shall be applicable.

(6) Computation and publication of ceiling prices

The Commission shall—

(A) not later than 5 days before the beginning of any month, compute and make available the maximum lawful prices prescribed under this subchapter for such month and the monthly equiva-

lent of the annual inflation adjustment factor for such month, and

(B) as soon as possible thereafter, publish such maximum lawful prices and such factor for such month in the Federal Register.

(7) Rounding

Any maximum lawful price under this subchapter shall be computed to the nearest mill (rounding any fraction thereof which is one-half a mill or higher to the next highest mill).

(8) Computation of initial ceiling prices

In computing any maximum lawful price under the provisions of this subchapter for the first month for which such provisions take effect, if the initial maximum lawful price is established by reference to any month before such month, such maximum lawful price shall be computed as if such provisions had been in effect during each such prior month.

(9) Effect on contract price

In the case of—

(A) any price which is established under any contract for the first sale of natural gas and which does not exceed the applicable maximum lawful price under this subchapter, or

(B) any price which is established under any contract for the first sale of natural gas which is exempted under part B of this subchapter from the application of a maximum lawful price under this subchapter,

such maximum lawful price, or such exemption from such a maximum lawful price, shall not supersede or nullify the effectiveness of the price established under such contract.

§ 3312. Ceiling price for new natural gas and certain natural gas produced from the Outer Continental Shelf

(a) Application

The maximum lawful price computed under subsection (b) of this section shall apply to any first sale of natural gas delivered during any month in the case of—

(1) new natural gas; and

(2) natural gas produced from any old lease on the Outer Continental Shelf and qualifying under subsection (d) of this section for the new natural gas ceiling price.

(b) Maximum lawful price

The maximum lawful price under this section for any month shall be—

(1) $1.75 per million Btu's, in the case of April 1977; and

(2) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subsection for the preceding month multiplied by the monthly equivalent of a factor equal to the sum of—

(A) the annual inflation adjustment factor applicable for such month; plus

(B)(i) .035, in the case of any month beginning before April 20, 1981; or

(ii) .04, in the case of any month beginning after April 20, 1981.

(c) "New natural gas" defined

(1) General rule

For the purposes of this section, the term "new natural gas" means each of the following categories of natural gas:

(A) New OCS leases

Natural gas determined in accordance with section 3413 of this title to be produced from a new lease on the Outer Continental Shelf.

(B) New onshore wells

Natural gas determined in accordance with section 3413 of this title to be produced (other than from the Outer Continental Shelf) from—

(i) any new well which is 2.5 miles or more (determined in accordance with paragraph (2)) from the nearest marker well; or

(ii) any completion location, of any new well, which is located at a depth at least 1,000 feet below the deepest completion location of each marker well within 2.5 miles (determined in accordance with paragraph (2)) of such new well.

(C) New onshore reservoirs

(i) General rule

Except as provided in clauses (ii) and (iii), natural gas determined in accordance with sec-

tion 3413 of this title to be produced (other than from the Outer Continental Shelf) from a reservoir from which natural gas was not produced in commercial quantities before April 20, 1977.

(ii) Behind-the-pipe exclusion

Clause (i) shall not apply to natural gas produced from any reservoir if—

(I) the reservoir was penetrated before April 20, 1977, by an old well from which natural gas or crude oil was produced in commercial quantities (whether or not such production was from such reservoir); and

(II) natural gas could have been produced in commercial quantities from such reservoir through such old well before April 20, 1977.

(iii) Withheld gas exclusion

Clause (i) shall not apply to natural gas produced from any reservoir—

(I) if such natural gas is produced through an old well; and

(II) subject to clause (iv), suitable facilities for the production and delivery to a pipeline of such natural gas were in existence on April 20, 1977.

(iv) Emergency sale facilities

The criteria of clause (iii)(II) shall not be considered to be met by reason of the existence of production and delivery faclities which were

installed to carry out sales and deliveries of natural gas—

(I) under section 6 of the Emergency Natural Gas Act of 1977; or

(II) under the emergency sale authority pursuant to Opinion 699-B issued by the Federal Power Commission under section 7(c) of the Natural Gas Act [15 U.S.C. 717f(c)].

(2) Determinations of distance

For purposes of determining the distance from any new well to any marker well—

(A) Surface location to surface location

The measurement shall be the horizontal distance from the surface location of the new well to the surface location of the marker well—

(i) in any case in which the new well meets requirements for the nondirectional drilling of wells prescribed by the appropriate State or Federal agency having regulatory jurisdiction over the drilling of such well; or

(ii) in any case in which—

(I) the surface drilling of such new well began on or after February 19, 1977;

(II) production of natural gas in commercial quantities began from such well before November 9, 1978; and

(III) the drilling of such well was not subject to any requirement regarding direc-

tional or nondirectional drilling, or the drilling of such wells subject to requirements regarding directional drilling but such requirements did not necessitate the obtaining of any permit or other certificate before drilling began.

(B) Completion location to surface location

In the case of any new well which is not covered by subparagraph (A), the measurements shall be the horizontal distance from —

(i) the closest point of any completion location of the new well, vertically projected to the same elevation as the surface location of the nearest marker well; to

(ii) the surface location of such marker well.

(3) Determination of commercial quantities

For purposes of determining whether production of natural gas has occurred in commercial quantities under paragraph (1)(C)—

(A) a rebuttable presumption exists that production from a reservoir in commercial quantities has not occurred if natural gas has not been sold and delivered from such reservoir before April 20, 1977; and

(B) quantities of natural gas sold in interstate commerce (within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.]) shall not be taken into account if such quantities were sold before November 9, 1978—

(i) under section 6 of the Emergency Natural Gas Act of 1977; or

(ii) under the emergency sale authority pursuant to Opinion 699-B issued by the Federal Power Commission under section 7(c) of the Natural Gas Act [15 U.S.C. 717f(c)].

(4) New wells which are also marker wells

For purposes of applying subsection (c)(1)(B)(ii) of this section in the case of any marker well which is also a new well under section 3301(3)(B) of this title, the reference in such subsection (c)(1)(B)(ii) of this section to the deepest completion location of any marker well shall be deemed to be a reference to any subsurface location from which natural gas was produced in commercial quantities after January 1, 1970, and before February 19, 1977.

(d) OCS gas qualifying for new natural gas ceiling price

For purposes of this section—

(1) OCS reservoirs discovered on or after July 27, 1976

Natural gas determined in accordance with section 3413 of this title to be produced from an old lease on the Outer Continental Shelf shall qualify for the new natural gas ceiling price if such natural gas is produced from a reservoir which was not discovered before July 27, 1976.

(2) Reservoirs penetrated before July 27, 1976

For purposes of paragraph (1), a reservoir shall be considered as having been discovered before July 27, 1976, if—

(A) such reservoir was penetrated by a well before July 27, 1976; and

(B) with respect to such well—

(i) the results of any production test meeting the requirements of OCS Order No. 4 demonstrate that, as of the time of such test, the reservoir is capable of producing in paying quantities (within the meaning of such Order);

(ii) any production capability evidence meeting the requirements of OCS Order No. 4 demonstrates that, as of the time such evidence is obtained, the reservoir is capable of producing in paying quantities (within the meaning of such Order); or

(iii) subject to paragraph (3), an induction-electric log, sidewall cores and core analysis, or a wire line formation test indicates that, as of the time of such test, the reservoir is commercially producible.

(3) Effect of negative production capability tests

For purposes of paragraph (1), a reservoir shall not be considered as having been discovered before July 27, 1976, by the penetration of such reservoir by a well before July 27, 1976, if, with respect to such well—

(A) a production test meeting the requirements of OCS Order No. 4 was performed and the results of such test fail to demonstrate that, as of the time of such test, such reservoir was capable of producing in paying quantities (within the meaning of such Order); and

(B) production capability evidence meeting the requirements of OCS Order No. 4 does not exist or, if existing, does not demonstrate that, as of the date such evidence was obtained, such reservoir was capable of producing in paying quantities (within the meaning of such Order).

(4) Burden of proof

For purposes of paragraph (1), the producer shall have the burden of showing that—

(A) no test described in paragraph (2)(B)(i) or (iii) was performed and no evidence described in paragraph (2)(B)(ii) or (iii) exists; or

(B) if any such test was performed or such evidence exists, the results of such test or such evidence do not provide the applicable demonstration or indication specified under paragraph (2).

(5) "OCS Order No. 4" defined

For purposes of this subsection, the term "OCS Order No. 4" means the order numbered 4 of the Conservation Division, Geological Survey, Department of the Interior, as approved by the Chief of the Conservation Division on August 28, 1969.

(e) Exclusion of certain Alaska natural gas

The preceding provisions of this section shall not apply to any natural gas produced from the Prudhoe Bay Unit of Alaska and transported through the natural gas transportation system approved under the Alaska Natural Gas Transportation Act of 1976 [15 U.S.C. 719 et seq.].

§ 3313. Ceiling price for new, onshore production wells

(a) Application

In the case of natural gas determined in accordance with section 3413 of this title to be produced from any new, onshore production well, the maximum lawful price computed under subsection (b) of this section shall apply to any first sale of such natural gas delivered during any month.

(b) Maximum lawful price

(1) General rule

The maximum lawful price under this section for any month shall be—

(A) $1.75 per million Btu's, in the case of April 1977; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

(2) Production after 1984 from wells 5,000 feet or less in depth

Effective beginning with the month of January 1985 and in any month thereafter, in the case of any first sale of natural gas which was not committed or dedicated to interstate commerce on April 20, 1977, and which is produced from a new, onshore production well from a completion location located at a depth of 5,000 feet or less, the maximum

lawful price under this section for any such natural gas delivered during any month shall be a price which is midway between—

(A) the maximum lawful price, per million Btu's, computed for such month under section 3312 of this title (relating to new natural gas); and

(B) the maximum lawful price, per million Btu's, computed for such month under paragraph (1).

(c) "New, onshore production well" defined

For purposes of this section, the term "new, onshore production well" means any new well (other than a well located on the Outer Continental Shelf)—

(1) the surface drilling of which began on or after February 19, 1977;

(2) which satisfies applicable Federal or State well-spacing requirements, if any; and

(3) which is not within a proration unit—

(A) which was in existence at the time the surface drilling of such well began;

(B) which was applicable to the reservoir from which such natural gas is produced; and

(C) which applied to a well (i) which produced natural gas in commercial quantities or (ii) the surface drilling of which was begun before February 19, 1977, and which was thereafter capable of producing natural gas in commercial quantities.

(d) Exclusion of certain Alaska natural gas

The preceding provisions of this section shall not apply to any natural gas produced from the Prudhoe Bay Unit of Alaska and transported through the natural gas transportation system approved under the Alaska Natural Gas Transportation Act of 1976 [15 U.S.C. 719 et seq.].

§ 3314. Ceiling price for sales of natural gas dedicated to interstate commerce

(a) Application

In the case of natural gas committed or dedicated to interstate commerce on November 8, 1978, and for which a just and reasonable rate under the Natural Gas Act [15 U.S.C. 717 et seq.] was in effect on such date for the first sale of such natural gas, the maximum lawful price computed under subsection (b) of this section shall apply to any first sale of such natural gas delivered during any month.

(b) Maximum lawful price

(1) General rule

The maximum lawful price under this section for any month shall be the higher of—

(A)(i) the just and reasonable rate, per million Btu's, established by the Commission which was (or would have been) applicable to the first sale of such natural gas on April 20, 1977, in the case of April 1977; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preced-

ing month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month, or

(B) any just and reasonable rate which was established by the Commission after April 27, 1977, and before November 9, 1978, and which is applicable to such natural gas.

(2) Ceiling prices may be increased if just and reasonable

The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.].

§ 3315. Ceiling price for sales under existing intrastate contracts

(a) Application

The maximum lawful price computed under subsection (b) of this section shall apply to any first sale of natural gas delivered during any month in the case of natural gas, sold under any existing contract or any successor to an existing contract, which was not committed or dedicated to interstate commerce on November 8, 1978.

(b) Maximum lawful price

(1) General rule

Subject to paragraphs (2) and (3), the maximum lawful price under this section shall be the lower of—

(A) the price under the terms of the existing contract, to which such natural gas was subject on November 9, 1978, as such contract was in effect on such date; or

(B) the maximum lawful price, per million Btu's, computed for such month under section 3312 of this title (relating to new natural gas).

(2) Contract price exceeding new gas ceiling price on November 9, 1978

In the case of any natural gas described in subsection (a) of this section for which the contract price applicable on November 9, 1978, exceeds the maximum lawful price, per million Btu's, computed for such date under section 3312 of this title (relating to new natural gas), the maximum lawful price under this section shall be the higher of—

(A) the maximum lawful price, per million Btu's, computed for such month under section 3312 of this title; or

(B)(i) the contact price on November 9, 1978, in the case of November 1978; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of

the annual inflation adjustment factor applicable for such month.

(3) Price increases resulting from indefinite price escalator clauses

(A) In general

Effective January 1985, and each month thereafter, in the case of any first sale of natural gas, which is sold at a price established under any indefinite price escalator clause of any existing contract or successor to an existing contract and for which the contract price on December 31, 1984, is higher than $1.00 per million Btu's, the maximum lawful price under this section for any such natural gas delivered during any month shall be the higher of—

(i) the maximum lawful price, per million Btu's, computed under paragraph (2)(B); or

(ii)(I) in the case of January 1985, the maximum lawful price, per million Btu's, computed under section 3312 of this title (relating to new natural gas) for such month; and

(II) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this clause for the immediately preceding month multiplied by the monthly equivalent of the sum of a factor equal to the annual inflation adjustment factor applicable for such month plus .03.

(B) "Indefinite price escalator clause" defined

For purposes of this paragraph, the term "in-

definite price escalator clause" includes any provision of any contract—

(i) which provides for the establishment or adjustment of the price for natural gas delivered under such contract by reference to other prices for natural gas, for crude oil, or for refined petroleum products; or

(ii) which allows for the establishment or adjustment of the price of natural gas delivered under such contract by negotiation between the parties.

(C) Contract modifications after May 3, 1978, to be disregarded

In the case of any natural gas which was subject to any contract on May 3, 1978, that contained an indefinite price escalator clause on such date, no amendment to or modification of the operation of such contract made after such date may have the effect of limiting or precluding the application of this paragraph on or after January 1, 1985, to prices allowed with respect to such natural gas.

(D) Exclusion

Subparagraph (A) shall not apply to any first sale of new natural gas (as defined in section 3312(c) of this title), stripper well natural gas (as defined in section 3318(b) of this title), high-cost natural gas (as defined in section 3317(c) of this title), natural gas produced from a new, onshore production well (as defined in section 3313(c) of this title) from a completion location

located at a depth of more than 5,000 feet, and, beginning July 1, 1987, or, if later, the date of expiration of any price controls reimposed under section 3332 of this title, natural gas produced from any new, onshore production well (as defined in section 3313(c) of this title) from a completion location located at a depth of 5,000 feet or less.

(c) "Contract price" defined

For purposes of this section, the term "contract price", when used with respect to any specific date, means—

(1) the price paid, per million Btu's, under a contract for deliveries of natural gas occurring on such date; or

(2) if no deliveries of natural gas occurred under such contract on such date, the price, per million Btu's, that would have been paid had such deliveries occurred on such date.

§ 3316. Ceiling price for sales under rollover contracts

(a) Interstate rollover contracts

In the case of any first sale under any rollover contract of natural gas which was committed or dedicated to interstate commerce on November 8, 1978, the maximum lawful price under this subsection for such natural gas delivered during any month shall be the higher of—

(1)(A) in the case of the month in which the effective date of such rollover contract occurs, the just and reasonable rate, if any, per million Btu's, established by the Commission and applicable on

such date to the natural gas subject to the expired contract; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month; or

(2)(A) $0.54 per million Btu's, in the case of April 1977; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month. For purposes of this subsection, the term "rollover contract" includes any contract which would have been a rollover contract but for the fact that the expiration of the previous contract occurred prior to November 8, 1978.

(b) Intrastate rollover contracts

(1) General rule

In the case of any first sale under any rollover contract of natural gas which was not committed or dedicated to interstate commerce on November 8, 1978, the maximum lawful price under this subsection for such natural gas delivered during any month shall be the higher of—

(A)(i) the maximum price paid under the expired contract, per million Btu's, in the case of

the month in which the effective date of such rollover contract occurs; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month; or

(B)(i) $1.00 per million Btu's, in the case of April 1977; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

(2) Certain State or Indian production or royalty shares

(A) General rule

In the case of any first sale under any rollover contract of natural gas which was not committed or dedicated to interstate commerce on November 8, 1978, and which constitutes a State government's or Indian tribe's natural gas production, or royalty share or other interest (as of such day) in natural gas production, from real property (including subsurface mineral interests) owned on November 9, 1978, by such State government or Indian tribe (as the case may be), the maximum lawful price under this subsection for any such natural gas delivered during any month shall be

the maximum lawful price, per million Btu's, computed for such month under section 3312 of this title (relating to new natural gas).

(B) Indian tribal lands

For purposes of this paragraph, land shall be considered to be owned by an Indian tribe only if—

(i) such land is owned directly by such tribe; or

(ii) such land is held by the United States or any State in trust for Indian persons and is located within the boundaries of an Indian reservation (as such boundaries were in effect on November 9, 1978).

(C) Definitions

For purposes of this paragraph—

(i) State government

The term "State government" means any State or any agency, instrumentality, or political subdivision of a State.

(ii) Indian tribe

The term "Indian tribe" means any Indian tribe recognized as eligible for services provided by the Secretary of the Interior to Indians.

(c) Ceiling price may be increased if just and reasonable

The Commission may, by rule or order, prescribe a maximum lawful price, applicable to any first sale of any natural gas (or category thereof, as determined by the

Commission) otherwise subject to the preceding provisions of this section, if such price is—

(1) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(2) just and reasonable within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.].

§ 3317. Ceiling price for high-cost natural gas

(a) Wells completed below 15,000 feet

In the case of any first sale of high-cost natural gas produced from any well the surface drilling of which began on or after February 19, 1977, if such production is from any completion location which is located at a depth of more than 15,000 feet, the maximum lawful price under this section for such natural gas delivered during any month shall be the maximum lawful price, per million Btu's, computed for such month under section 3312 of this title (relating to new natural gas).

(b) Commission authority to prescribe higher incentive prices

The Commission may, by rule or order, prescribe a maximum lawful price, applicable to any first sale of any high-cost natural gas, which exceeds the otherwise applicable maximum lawful price to the extent that such special price is necessary to provide reasonable incentives for the production of such high-cost natural gas.

(c) "High-cost natural gas" defined

For purposes of this section, the term "high-cost natural gas" means natural gas determined in accordance with section 3413 of this title to be—

(1) produced from any well the surface drilling of which began on or after February 19, 1977, if such production is from a completion location which is located at a depth of more than 15,000 feet;

(2) produced from geopressured brine;

(3) occluded natural gas produced from coal seams;

(4) produced from Devonian shale; and

(5) produced under such other conditions as the Commission determines to present extraordinary risks or costs.

(d) Provisions for high-cost natural gas to be elective

If any credit, exemption, deduction, or comparable adjustment applicable to the computation of any Federal tax is specifically allowable with respect to any high-cost natural gas (or category thereof) under any provision of law enacted after November 9, 1978, the provisions of subsections (a) and (b) of this section and the provisions of part B of this subchapter shall not apply to such natural gas produced from any well unless an election to have such provisions apply (in lieu of such credit, exemption, deduction, or adjustment) with respect to such natural gas produced from such well is filed with the Commission on or before the later of—

(A) the 30th day after November 9, 1978, under which such credit, exemption, deduction, or adjustment is provided; or

(B) the date the surface drilling of such well began.

§ 3318. Ceiling price for stripper well natural gas

(a) General rule

In the case of any first sale of stripper well natural gas the maximum lawful price under this section for such natural gas delivered during any month shall be—

(1) $2.09 per million Btu's, in the case of May 1978; and

(2) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subsection for the preceding month multiplied by the monthly equivalent of a factor equal to the sum of—

(A) the annual inflation adjustment factor applicable for such months; plus

(B)(i) .035 in the case of any month beginning before April 20, 1981; or

(ii) .04, in the case of any month beginning after April 20, 1981.

(b) "Stripper well natural gas" defined

(1) General rule

Except as provided in paragraph (2), the term "stripper well natural gas" means natural gas determined in accordance with section 3413 of this title to be nonassociated natural gas produced during any month from a well if—

(A) during the preceding 90-day production period, such well produced nonassociated natural gas at a rate which did not exceed an average of 60 Mcf per production day during such period; and

(B) during such period such well produced at its maximum efficient rate of flow, determined in accordance with recognized conservation practices designed to maximize the ultimate recovery of natural gas.

(2) Production in excess of 60 Mcf

The Commission shall, by rule, provide that, if nonassociated natural gas produced from a well which previously qualified as a stripper well under paragraph (1) exceeds an average of 60 Mcf per production day during any 90-day production period, such natural gas may continue to qualify as stripper well natural gas if the increase in nonassociated natural gas produced from such well was the result of the application of recognized enhanced recovery techniques.

(3) Definitions

For purposes of this subsection—

(A) Production day

The term "production day" means—

(i) any day during which natural gas is produced; and

(ii) any day during which natural gas is not produced if production during such day is prohibited by a requirement of State law or a conservation practice recognized or approved by the State agency having regulatory jurisdiction over the production of natural gas.

(B) 90-day production period

The term "90-day production period" means

any period of 90 consecutive calendar days excluding any day during which natural gas is not produced for reasons other than voluntary action of any person with the right to control production of natural gas from such well.

(C) Nonassociated natural gas

The term "nonassociated natural gas" means natural gas which is not produced in association with crude oil.

§ 3319. Ceiling price for other categories of natural gas

(a) Application

The maximum lawful price computed under subsection (b) of this section shall apply to any first sale of any natural gas delivered during any month, in the case of any natural gas which is not covered by any maximum lawful price under any other section of this part, including—

(1) natural gas produced from any new well not otherwise qualifying for a higher maximum lawful price under this subchapter;

(2) natural gas committed or dedicated to interstate commerce on November 8, 1978, and for which a just and reasonable rate under the Natural Gas Act [15 U.S.C. 717 et seq.] was not in effect on such date for the first sale of such natural gas;

(3) natural gas which was not committed or dedicated to interstate commerce on November 8, 1978, and which was not subject to an existing contract on such day; and

(4) natural gas produced from the Prudhoe Bay Unit of Alaska and transported through the natural gas transportation system approved under the Alaska Natural Gas Transportation Act of 1976 [15 U.S.C. 719 et seq.].

(b) Maximum lawful price

(1) The maximum lawful price under this section for any month shall be—

(A) $1.45 per million Btu's, in the case of April 1977; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

(2) The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.].

§ 3320. Treatment of State severance taxes and certain production-related costs

(a) Allowance for State severance taxes and certain production-related costs

Except as provided in subsection (b) of this section, a price for the first sale of natural gas shall not be considered to exceed the maximum lawful price applicable to the first sale of such natural gas under this part if such first sale price exceeds the maximum lawful price to the extent necessary to recover—

(1) State severance taxes attributable to the production of such natural gas and borne by the seller, but only to the extent the amount of such taxes does not exceed the limitation of subsection (b) of this section; and

(2) any costs of compressing, gathering, processing, treating, liquefying, or transporting such natural gas, or other similar costs, borne by the seller and allowed for, by rule or order, by the Commission.

(b) Limitation on State severance taxes

The State severance tax allowable under subsection (a)(1) of this section with respect to the production of any natural gas may not include any amount of State severance taxes borne by the seller which results from a provision of State law enacted on or after December 1, 1977, unless such provision of law is equally applicable to natural gas produced in such State and delivered in interstate commerce and to natural gas produced in such State and not so delivered.

(c) "State severance tax" defined

For purposes of this section, the term "State severance tax" means any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas—

(1) by any State or Indian tribe (as defined in section 3316(b)(2)(B)(ii) of this title); and

(2) by any political subdivision of a State if the authority to impose such tax, fee, or other levy is granted to such political subdivision under State law.

§ 3331. Elimination of price controls for certain natural gas sales

(a) General rule

Subject to the reimposition of price controls as provided in section 3332 of this title, the provisions of part A of this subchapter respecting the maximum lawful price for the first sale of each of the following categories of natural gas shall, except as provided in subsections (d) and (e) of this section, cease to apply effective January 1, 1985:

(1) New natural gas

New natural gas (as defined in section 3312(c) of the title).

(2) New, onshore production wells

Natural gas produced from any new, onshore production well (as defined in section 3313(c) of this title), if such natural gas—

(A) was not committed or dedicated to interstate commerce on April 20, 1977; and

(B) is produced from a completion location which is located at a depth of more than 5,000 feet.

(3) Intrastate contracts in excess of $1.00

Natural gas sold under an existing contract, any

successor to an existing contract, or any rollover contract, if—

(A) such natural gas was not committed or dedicated to interstate commerce on November 8, 1978; and

(B) the price paid for the last deliveries of such natural gas occurring on December 31, 1984, or, if no deliveries occurred on such date, the price would have been paid had deliveries occurred on such date is higher than $1.00 per million Btu's.

(b) High-cost natural gas

Effective beginning on the effective date of the incremental pricing rule required under section 3341 of this title, the provisions of part A of this subchapter respecting the maximum lawful price for the first sale of natural gas shall cease to apply to the first sale of high-cost natural gas which is described in section 3317(c)(1), (2), (3), or (4) of this title.

(c) Natural gas produced from 5,000 feet or less

Effective beginning July 1, 1987, or, if later, the date of expiration of any price controls reimposed under section 3332 of this title, the provisions of part A of this subchapter respecting the maximum lawful price for any first sale of natural gas shall, except as provided in subsection (d) of this section, cease to apply to any first sale of natural gas produced from any new, onshore production well (as defined in section 3313(c) of this title), if such natural gas—

(1) was not committed or dedicated to interstate commerce on April 20, 1977; and

(2) is produced from a completion location which is located at a depth of 5,000 feet or less.

(d) Exclusion of certain Alaska natural gas

The provisions of subsections (a) and (c) of this section shall not apply to any natural gas produced from the Prudhoe Bay Unit of Alaska and transported through the natural gas transportation system approved under the Alaska Natural Gas Transportation Act of 1976 [15 U.S.C. 719 et seq.].

(e) Limitation on indefinite price escalators

Natural gas which is not subject to maximum lawful prices under part A of this subchapter solely by reason of subsection (a)(3) of this section and which is sold under any existing contract or successor to an existing contract at a price established under an indefinite price escalator clause (as defined in section 3315(b)(3)(B) of this title) shall be subject to the provisions of section 3315(b)(3) of this title.

§ 3332. Standby price control authority

(a) Reimposition of price controls.

The President, in accordance with subsection (c)(1) of this section, or the Congress, in accordance with subsection (c)(2) of this section, may reimpose maximum lawful prices for first sales of natural gas to which section 3331(a) of this title applies and delivery of which occurs after the effective date of the reimposition of such maximum lawful prices.

(b) Limitations

A reimposition of maximum lawful prices uner this section—

(1) may not take effect earlier than July 1, 1985, nor later than June 30, 1987; and

(2) shall remain in effect for a period of 18 months.

(c) Procedure for reimposing price controls

For purposes of this section—

(1) Presidential reimposition

Any exercise of authority by the President under subsection (a) of this section shall be by written order issued after May 31, 1985, and, subject to subsection (b) of this section, shall take effect for the first month beginning after the first 30 calendar days of continuous session of Congress (as determined in accordance with section 3417(b) of this title) after a copy of such order has been submitted to each House of the Congress unless during such 30 calendar days of continuous session of Congress, the Congress adopts a concurrent resolution of disapproval described in section 3417(c)(1) of this title.

(2) Congressional reimposition

Any exercise of authority by the Congress under subsection (a) of this section shall be by the adoption of a concurrent resolution after May 31, 1985, described in section 3417(c)(2) of this title, and, subject to subsection (b) of this section, shall take effect for the first month beginning after the date of the adoption of such resolution.

(d) Maximum lawful prices applicable under reimposition of price control

If maximum lawful prices are reimposed under this section on first sales of natural gas to which section 3331(a) of this title applies, the maximum lawful price under this section for any first sale of such natural gas delivered during any month shall be—

(1) except as provided in paragraph (2), the maximum lawful price, per million Btu's, computed for such month under section 3312 of this title (relating to new natural gas); and

(2) the maximum lawful price, per million Btu's, computed for such month under section 3313(b)(2) of this title (relating to new, onshore production wells 5,000 feet or less in depth), in the case of natural gas produced from any new, onshore production well (as defined in section 3313(c) of this title) if such natural gas—

(A) was not committed or dedicated to interstate commerce on April 20, 1977; and

(B) is produced from a completion location which is located at a depth of 5,000 feet or more.

(e) Allowance for State severance taxes and certain production-related costs.

A price may exceed the maximum lawful price applicable for such natural gas under this section to the same extent as is provided under section 3320 of this title with respect to maximum lawful prices under part A of this sub-chapter.

(f) Limitation

Maximum lawful prices may be reimposed only once under this section.

§ 3333. Report to the Congress

(a) Reports

On or before July 1, 1984, and on or before January 1, 1985, the Department of Energy shall prepare and transmit to the President and to each House of the Congress a report on natural gas prices, supplies, and demand, and the competitive conditions and market forces in the natural gas industry in the United States. Each such report shall include an evaluation by the Department of Energy whether equilibrium exists between supply and demand for natural gas.

(b) Public comment

In preparing each report required under subsection (a) of this section, the Department of Energy shall provide an opportunity for public comment with respect to matters required under subsection (a) of this section to be included in such report.

§ 3361. Declaration of emergency

(a) Presidential declaration

The President may declare a natural gas supply emergency (or extend a previously declared emergency) if he finds that—

(1) a severe natural gas shortage, endangering the supply of natural gas for high-priority uses, exists or is imminent in the United States or in any region thereof; and

(2) the exercise of authorities under section 3362 or section 3363 of this title is reasonably necessary, having exhausted other alternatives to the

maximum extent practicable, to assist in meeting natural gas requirements for such high-priority uses.

(b) Limitation

(1) Expiration

Any declaration of a natural gas supply emergency (or extension thereof) under subsection (a) of this section, shall terminate at the earlier of—

(A) the date on which the President finds that any shortage described in subsection (a) of this section does not exist or is not imminent; or

(B) 120 days after the date of such declaration of emergency (or extension thereof).

(2) Extensions

Nothing in this subsection shall prohibit the President from extending, under subsection (a) of this section, any emergency (or extension thereof), previously declared under subsection (a) of this section, upon the expiration of such declaration of emergency (or extension thereof) under paragraph (1)(B).

§ 3362. Emergency purchase authority

(a) Presidential authorization

During any natural gas supply emergency declared under section 3361 of this title, the President may, by rule or order, authorize any interstate pipeline or local distribution company served by any interstate pipeline to contract, upon such terms and conditions as the President determines to be appropriate (including provisions re-

specting fair and equitable prices), for the purchase of emergency supplies of natural gas—

(1) from any producer of natural gas (other than a producer who is affiliated with the purchaser, as determined by the President) if—

(A) such natural gas is not produced from the Outer Continental Shelf; and

(B) the sale or transportation of such natural gas was not pursuant to a certificate issued under the Natural Gas Act [15 U.S.C. 717 et seq.] immediately before the date on which such contract was entered into; or

(2) from any intrastate pipeline, local distribution company, or other person (other than an interstate pipeline or a producer of natural gas).

(b) Contract duration

The duration of any contract authorized under subsection (a) of this section may not exceed 4 months. The preceding sentence shall not prohibit the President from authorizing under subsection (a) of this section a renewal of any contract, previously authorized under such subsection, following the expiration of such contract.

(c) Related transportation and facilities

The President may, by order, require any pipeline to transport natural gas, and to construct and operate such facilities for the transportation of natural gas, as he determines necessary to carry out any contract authorized under subsection (a) of this section. The costs of any construction or transportation ordered under this subsection shall be paid by the purchaser of natural

gas under the contract with respect to which such order is issued. No order to transport natural gas under this subsection shall require any pipeline to transport natural gas in excess of such pipeline's available capacity.

(d) Maintenance of adequate records

The Commission shall require any interstate pipeline or local distribution company contracting under the authority of this section for natural gas to maintain and make available full and adequate records concerning transactions under this section, including records of the volumes of natural gas purchased under the authority of this section and the rates and charges for purchase and receipt of such natural gas.

(e) Special limitation

No sale under any emergency purchase contract under this section for emergency supplies of natural gas for sale and delivery from any intrastate pipeline which is operating under court supervision as of January 1, 1977, may take effect unless the court approves.

§ 3363. Emergency allocation authority

(a) In general

In order to assist in meeting natural gas requirements for high-priority uses of natural gas during any natural gas supply emergency declared under section 3361 of this title, the President may, by order, allocate supplies of natural gas under subsections (b), (c), and (d) of this section to—

(1) any interstate pipeline;

(2) any local distribution company—

(A) which is served by any interstate pipeline;

(B) which is providing natural gas only for high-priority uses; and

(C) which is in need of deliveries of natural gas to assist in meeting natural gas requirements for high-priority uses of natural gas; and

(3) any person for meeting requirements of high-priority uses of natural gas.

(b) Allocation of certain boiler fuel gas

(1) Required finding

The President shall not allocate supplies of natural gas under this subsection unless he finds that—

(A) to the maximum extent practicable, emergency purchase authority under section 3362 of this title has been utilized to assist in meeting natural gas requirements for high-priority uses of natural gas;

(B) emergency purchases of natural gas supplies under section 3362 of this title are not likely to satisfy the natural gas requirements for such high-priority uses;

(C) the exercise of authority under this subsection is reasonably necessary to assist in meeting natural gas requirements for such high-priority uses; and

(D) any interstate pipeline or local distribution company receiving such natural gas has ordered the termination of all deliveries of natural gas for other than high-priority uses and attempted

to to the maximum extent practicable to terminate such deliveries.

(2) Allocation authority

Subject to paragraph (1), in order to assist in meeting natural gas requirements for high-priority uses of natural gas, the President may, by order, allocate supplies of natural gas the use of which has been prohibited by the President pursuant to authority under section 717z of this title (relating to the use of natural gas as a boiler fuel during any natural gas supply emergency).

(c) Allocation of general pipeline supply

(1) Required findings

The President shall not allocate supplies of natural gas under this subsection unless he finds that—

(A) to the maximum extent practicable, allocation of supplies of natural gas under subsection (b) of this section has been utilized to assist in meeting natural gas requirements for high-priority uses of natural gas;

(B) the exercise of such authority is not likely to satisfy the natural gas requirements for such high-priority uses;

(C) the exercise of authority under this subsection is reasonably necessary to assist in meeting natural gas requirements for such high-priority uses;

(D) any interstate pipeline or local distribution company receiving such natural gas has ordered the termination of all deliveries of natural gas

for other than high-priority uses and attempted to the maximum extent practicable to terminate such deliveries;

(E) such allocation will not create, for the interstate pipeline delivering certificated natural gas, a supply shortage which will cause such pipeline to be unable to meet the natural gas requirements for high-priority uses of natural gas served, directly or indirectly, by such pipeline; and

(F) such allocation will not result in a disproportionate share of deliveries and resulting curtailments of natural gas being experienced by such interstate pipeline when compared to deliveries and resulting curtailments which are experienced as a result of orders issued under this subsection applicable to other interstate pipelines (as determined by the President).

(2) Required notification from State

(A) Notification

The President shall not allocate supplies of natural gas under this subsection unless he is notified by the Governor of any State that—

(i) a shortage of natural gas supplies available to such State exists or is imminent;

(ii) such shortage or imminent shortage endangers the supply of natural gas for high-priority uses in such State; and

(iii) the exercise of authority under State law is inadequate to protect high-priority uses

of natural gas in such State from an interruption in natural gas supplies.

(3) Basis of finding

To the maximum extent practicable, the Governor shall submit, together with any notification under subparagraph (A), information upon which he has based his finding under such subparagraph, including—

(i) volumes of natural gas required to meet the natural gas requirements for high-priority uses of natural gas in such State;

(ii) information received from persons in the business of producing, selling, transporting, or delivering natural gas in such State as to the volumes of natural gas supplies available to such State;

(iii) information on the authority under State law which will be exercised to protect high-priority uses; and

(iv) such other information which the President requests or which the Governor determines appropriate to apprise the President of emergency deliveries and transportation of interstate natural gas needed by such State.

(4) Allocation authority

Subject to paragraphs (1), (2), and (5), in order to assist in meeting natural gas requirements for high-priority uses of natural gas, the President may, by order, allocate supplies of certificated natural gas from any interstate pipeline.

(5) Consideration of alternative fuel availability

In issuing any order under this subsection the President shall consider the relative availability of alternative fuel to natural gas users supplied by the interstate pipeline ordered to make deliveries pursuant to this subsection.

(d) Allocation of user-owned gas

(1) Required finding

The President shall not allocate supplies of natural gas under this subsection unless he finds that—

(A) to the maximum extent practicable, allocation of supplies of natural gas under subsection (c) of this section has been utilized to assist in meeting natural gas requirements for high-priority uses of natural gas;

(B) the exercise of such authority is not likely to satisfy the natural gas requirements for such high-priority uses;

(C) the exercise of authority under this subsection is reasonably necessary to assist in meeting natural gas requirements for such high-priority uses;

(D) any interstate pipeline or local distribution company receiving such natural gas has ordered the termination of all deliveries of natural gas for other than high-priority uses and attempted to the maximum extent practicable to terminate such deliveries; and

(E) such allocation will not create, for the person who owns and would otherwise use such

natural gas, a supply shortage which will cause such person to be unable to satisfy such person's natural gas requirements for high-priority uses.

(2) Allocation authority

Subject to paragraphs (1) and (3), in order to assist in meeting natural gas requirements for high-priority uses of natural gas, the President may, by order, allocate supplies of natural gas which would be certificated natural gas but for the second sentence of section 3301(19) of this title.

(3) Consideration of economic feasibility of alternative fuels

In issuing any order under this subsection, the President shall consider the economic feasibility of alternative fuels available to the user which owned the natural gas subject to an order under this subsection.

(e) Limitation

No order may be issued under this section unless the President determines that such order will not require transportation of natural gas by any pipeline in excess of its available transportation capacity.

(f) Industry assistance

The President may request that representatives of pipelines, local distribution companies, and other persons meet and provide assistance to the President in carrying out his authority under this section.

(g) Compensation

(1) In general

If the parties to any order issued under subsection

(b), (c), (d), or (h) of this section fail to agree upon the terms of compensation for natural gas deliveries or transportation required pursuant to such order, the President, after a hearing held either before or after such order takes effect, shall, by supplemental order, prescribe the amount of compensation to be paid for such deliveries or transportation and for any other expenses incurred in delivering or transporting natural gas.

(2) Calculation of compensation for certain boiler fuel natural gas

For purposes of any supplemental order under paragraph (1) with respect to emergency deliveries pursuant to subsection (b) of this section, the President shall calculate the amount of compensation—

(A) for supplies of natural gas based upon the amount required to make whole the user subject to the prohibition order, but in no event may such compensation exceed just compensation prescribed in section 717z of this title; and

(B) for transportation, storage, delivery, and other services, based upon reasonable costs, as determined by the President.

(3) Compensation for other natural gas allocated

For purposes of any supplemental order under paragraph (1), if the party making emergency deliveries pursuant to subsection (c) or (d) of this section—

(A) indicates a preference for compensation in kind, the President shall direct that compensa-

tion in kind be provided as expeditiously as practicable;

(B) indicates a preference for compensation, or the President determines that, notwithstanding paragraph (A) of this subsection, any portion thereof cannot practicably be compensated in kind, the President shall calculate the amount of compensation—

(i) for supplies of natural gas, based upon the amount required to make the pipeline and its local distribution companies whole, in the case of any order under subsection (c) of this section, or to make the user from whom natural gas is allocated whole, in the case of any order under subsection (d) of this section including any amount actually paid by such pipeline and its local distribution companies or such user for volumes of natural gas or higher cost synthetic gas acquired to replace natural gas subject to an order under subsection (c) or (d) of this section; and

(ii) for transportation, storage, delivery, and other services, based upon reasonable costs, as determined by the President. Compensation received by an interstate pipeline under this subsection shall be credited to the account of any local distribution company served by that pipeline to the extent ordered by the President to make such local distribution company whole.

(h) Related transportation and facilities

The President may, by order, require any pipeline to transport natural gas, and to construct and operate such

facilities for the transportation of natural gas, as he determines necessary, to carry out any order under subsection (b), (c), or (d) of this section. Compensation for the costs of any construction or transportation ordered under this subsection shall be determined under subsection (g) of this section and shall be paid by the person to whom supplies of natural gas are ordered allocated under this section.

(i) Monitoring

In order to effect the purposes of this part, the President shall monitor the operation of any order made pursuant to this section to assure that natural gas delivered pursuant to this section is applied to high-priority uses only.

(j) Commission study

Not later than June 1, 1979, the Commission shall prepare and submit to the Congress a report regarding whether authority to allocate natural gas, which is not otherwise subject to allocation under this part, is likely to be necessary to meet high-priority uses.

(k) "High-priority use" defined

For purposes of this section, the term "high-priority use" means any—

(1) use of natural gas in a residence;

(2) use of natural gas in a commercial establishment in amounts less than 50 Mcf on a peak day; or

(3) any use of natural gas the curtailment of which the President determines would endanger life, health, or maintenance of physical property.

§ 3364. Miscellaneous provisions

(a) Information

(1) Obtaining of information

In order to obtain information to carry out his authority under this part, the President may—

(A) sign and issue subpenas for the attendance and testimony of witnesses and the production of books, records, papers, and other documents;

(B) require any person, by general or special order, to submit answers in writing to interrogatories, requests for reports or for other information, and such answers shall be made within such reasonable period, and under oath or otherwise as the President may determine; and

(c) secure, upon request, any information from any Federal agency.

(2) Enforcement of subpenas and orders

The appropriate United States district court may, upon petition of the Attorney General at the request of the President, in the case of refusal to obey a subpena or order of the President issued under this subsection, issue an order requiring compliance therewith, and any failure to obey an order of the court may be punished by the court as a contempt thereof.

(b) Reporting of prices and volumes

In issuing any order under section 3362 or 3363 of this title, the President shall require that the prices and

volumes of natural gas delivered, transported, or contracted for pursuant to such order shall be reported to him on a weekly basis. Such reports shall be made available to the Congress.

(c) Presidential reports to Congress

The President shall report to the Congress, not later than 90 days following the termination under section 3361(b) of this title of any declaration of a natural gas supply emergency (or extension thereof) under section 3361(a) of this title, respecting the exercise of authority under section 3361, 3362, 3363 of this title, or this section.

(d) Delegation of authorities

The President may delegate all or any portion of the authority granted to him under section 3361, 3362, 3363 of this title, or this section to such Federal officers or agencies as he determines appropriate, and may authorize such redelegation as may be appropriate. Except with respect to section 552 of title 5, any Federal officer or agency to which authority is delegated or redelegated under this subsection shall be subject only to such procedural requirements respecting the exercise of such authority as the President would be subject to if such authority were not so delegated.

(e) Antitrust protections

(1) Defenses

There shall be available as a defense for any person to civil or criminal action brought for violation of the Federal antitrust laws (or any similar law of any State) with respect to any action taken, or meeting held, pursuant to any order of the Presi-

dent under section 3363(b), (c), (d), or (i) of this title, or any meeting held pursuant to a request of the President under section 3363(g) of this title, if—

(A) such action was taken or meeting held solely for the purpose of complying with the President's request or order;

(B) such action was not taken for the purpose of injuring competition; and

(C) any such meeting complied with the requirements of paragraph (2).

Persons interposing the defense provided by this subsection shall have the burden of proof, except that the burden shall be on the person against whom the defense is asserted with respect to whether the actions were taken for the purpose of injuring competition.

(2) Requirements of meetings

With respect to any meeting held pursuant to a request by the President under section 3363(g) of this title or pursuant to an order under section 3363 of this title—

(A) there shall be present at such meeting a full-time Federal employee designated for such purposes by the Attorney General;

(B) a full and complete record of such meeting shall be taken and deposited, together with any agreements resulting therefrom, with the Attorney General, who shall make it available for public inspection and copying;

(C) the Attorney General and the Federal Trade Commission shall have the opportunity to participate from the beginning in the development and carrying out of agreements and actions under section 3363 of this title, in order to propose any alternative which would avoid or overcome, to the greatest extent practicable, possible anti-competitive effects while achieving substantially the purposes of section 3363 of this title and any order thereunder; and

(D) such other procedures as may be specified by the President in such request or order shall be complied with.

(f) Effect on certain contractual obligations

There shall be available as a defense to any action brought for breach of contract under Federal or State Law arising out of any act or omission that such act was taken or that such omission occurred for purposes of complying with any order issued under section 3363 of this title.

(g) Preemption

Any order issued pursuant to this subchapter shall preempt any provision of any program for the allocation, emergency delivery, transportation, or purchase of natural gas established by any State or local government if such program is in conflict with any such order.

§ 3371. Authorization of certain sales and transportation

(a) Commission approval of transportation

(1) Interstate pipelines

(A) In general

The Commission may, by rule or order, au-

thorize any interstate pipeline to transport natural gas on behalf of—

(i) any intrastate pipeline; and

(ii) any local distribution company.

(B) Just and reasonable rates

The rates and charges of any interstate pipeline with respect to any transportation authorized under subparagraph (A) shall be just and reasonable (within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.]).

(2) Intrastate pipelines

(A) In general

The Commission may, by rule or order, authorize any intrastate pipeline to transport natural gas on behalf of—

(i) any interstate pipeline; and

(ii) any local distribution company served by any interstate pipeline.

(B) Rates and charges

(i) Maximum fair and equitable price

The rates and charges of any intrastate pipeline with respect to any transportation authorized under subparagraph (A), including any amount computed in accordance with the rule prescribed under clause (ii), shall be fair and equitable and may not exceed an amount which is reasonably comparable to the rates and charges which interstate pipelines would be per-

mitted to charge for providing similar transportation service.

(ii) Commission rule

The Commission shall, by rule, established the method for calculating an amount necessary to—

(I) reasonably compensate any intrastate pipeline for expenses incurred by the pipeline and associated with the providing of any gathering, treatment, processing, transportation, delivery, or similar service provided by such pipeline in connection with any transportation of natural gas authorized under subparagraph (A); and

(II) provide an opportunity for such pipeline to earn a reasonable profit on such services.

(b) Commission approval of sales

(1) In general

The Commission may, by rule or order, authorize any intrastate pipeline to sell natural gas to—

(A) any interstate pipeline; and

(B) any local distribution company served by any interstate pipeline.

(2) Rates and charges

(A) Maximum fair and equitable price

The rates and charges of any intrastate pipeline with respect to any sale of natural gas authorized

under paragraph (1) shall be fair and equitable and may not exceed the sum of—

(i) such intrastate pipeline's weighted average acquisition cost of natural gas;

(ii) an amount, computed in accordance with the rule prescribed under subparagraph (B); and

(iii) any adjustment permitted under subparagraph (C).

(B) Commission rule

The Commission shall, by rule, establish the method for calculating an amount necessary to—

(i) reasonably compensate any intrastate pipeline for expenses incurred by the pipeline and associated with the providing of any gathering, treatment, processing, transportation, or delivery service provided by such pipeline in connection with any sale of natural gas authorized under paragraph (1); and

(ii) provide an opportunity for such pipeline to earn a reasonable profit on such services.

(C) Adjustment

(i) Application

This subparagraph shall apply in any case in which, in order to deliver any volume of natural gas pursuant to any sale authorized under paragraph (1), any intrastate pipeline acquires quantities of natural gas under any existing contract, if—

(I) such intrastate pipeline acquires any volume of natural gas under such contract in excess of that which such pipeline would otherwise have acquired; and

(II) the price paid for such additional volume of natural gas acquired under such contract is greater than such pipeline's weighted average acquisition cost of natural gas, computed without regard to the acquisition of such additional volume of natural gas.

(ii) Commission adjustment

In any case to which this subparagraph applies, the Commission shall permit an adjustment to the maximum fair and equitable price provided under subparagraph (A) to increase the revenue to the intrastate pipeline under such sale by an amount determined by the Commission to be adequate to offset the additional cost incurred by such pipeline due to any increase in such pipeline's weighted average acquisition cost of natural gas.

(3) Limitation

(A) Two-year duration

No authorization of any sale (or any extension thereof) under paragraph (1) may be for a period exceeding two years.

(B) Extension

Any authorization of any sale under paragraph (1), and any extension of any such authorization under this subparagraph, may be extended by the

Commission if such extension satisfies the requirements of this subsection.

(4) Adequacy of service to intrastate customers

Any sale authorized under paragraph (1) shall be subject to interruption to the extent that natural gas subject to such sale is required to enable the intrastate pipeline involved to provide adequate service to such pipeline's customers at the time of such sale.

(5) Procedural requirements

(A) Affidavit

Any application for authorization of any sale under paragraph (1) shall be accompanied by an affidavit filed by the intrastate pipeline involved and setting forth—

(i) the identity of the interstate pipeline or local distribution company involved;

(ii) each point of delivery of the natural gas from the intrastate pipeline;

(iii) the estimated total and daily volumes of natural gas subject to such sale;

(iv) the price or prices of such volumes; and

(v) such other information as the Commission may, by rule, require.

(B) Verification of compliance

Any application for authorization of any sale under paragraph (1) shall be accompanied by a statement by the intrastate pipeline involved verifying by oath or affirmation that such sale, if au-

thorized, would comply with all requirements applicable to such sale under this subsection and all terms and conditions established, by rule or order, by the Commission and applicable to such sale.

(6) Termination of sales

(A) Hearing

Upon complaint of any interested person, or upon the Commission's own motion, the Commission shall, after affording an opportunity for oral presentation of views and arguments, terminate any sale authorized under paragraph (1) if the Commission determines—

(i) such termination is required to enable the intrastate pipeline involved to provide adequate service to the customers of such pipeline at the time of such sale;

(ii) such sale involves the sale of natural gas acquired by the intrastate pipeline involved solely or primarily for the purpose of resale of such natural gas pursuant to a sale authorized under paragraph (1);

(iii) such sale violates any requirement of this subsection or any term or condition established, by rule or order, by the Commission and applicable to such sale; or

(iv) such sale circumvents or violates any provision of this chapter.

(B) Suspension pending hearing

Prior to any hearing or determination required under subparagraph (A), upon complaint of any

interested person or upon the Commission's own motion, the Commission may suspend any sale authorized under paragraph (1) if the Commission finds that it is likely that the determinations described in subparagraph (A) will be made following the hearing required under subparagraph (A).

(C) Determination

The determination of whether any interruption of any sale authorized under paragraph (1) is required under subparagraph (A)(i) shall be made by the Commission without regard to the character of the use of natural gas by any customer of the intrastate pipeline involved.

(D) State intervention

Any interested State may intervene as a matter of right in any proceeding before the Commission relating to any determination under this section.

(7) Disapproval of application

The Commission shall disapprove any application for authorization of any sale under paragraph (1) if the Commission determines—

(A) such sale would impair the ability of the intrastate pipeline involved to provide adequate service to its customers at the time of such sale (without regard to the character of the use of natural gas by such customer);

(B) such sale would involve the sale of natural gas acquired by the intrastate pipeline involved solely or primarily for the purpose of resale of such natural gas pursuant to a sale authorized under paragraph (1);

(C) such sale would violate any requirement of this subsection or any term or condition established, by rule or order, by the Commission and applicable to such sale; or

(D) such sale would circumvent or violate any provision of this chapter.

(c) Terms and conditions

Any authorization granted under this section shall be under such terms and conditions as the Commission may prescribe.

§ 3372. Assignment of contractual rights to receive surplus natural gas

(a) Authorization of assignments

The Commission may, by rule or order, authorize any intrastate pipeline to assign, without compensation, to any interstate pipeline or local distribution company all or any portion of such intrastate pipeline's right to receive surplus natural gas at any first sale, upon such terms and conditions as the Commission determines appropriate.

(b) Effect of authorization under subsection (a)

For the effect of an authorization under subsection (a) of this section, see section 3431 of this title (relating to the coordination of this chapter with the Natural Gas Act [15 U.S.C. 717 et seq.]).

(c) Surplus natural gas

For purposes of this section, the term "surplus natural gas" means any natural gas—

(1) which is not committed or dedicated to interstate commerce on November 8, 1978;

(2) the first sale of which is subject to a maximum lawful price established under subchapter I of this chapter; and

(3) which is determined, by the State agency having regulatory jurisdiction over the intrastate pipeline which would be entitled to receive such natural gas in the absence of any assignment to exceed the then current demands on such pipeline for natural gas.

§ 3373. Effect of certain natural gas prices on indefinite price escalator clauses

(a) High-cost natural gas

No price paid in any first sale of high-cost natural gas (as defined in section 3317(c) of this title) may be taken into account in applying any indefinite price escalator clause (as defined in section 3315(b)(3)(B) of this title) with respect to any first sale of any natural gas other than high-cost natural gas (as defined in section 3317(c) of this title).

(b) Other transactions

No price paid—

(1) in any sale authorized under section 3362(a) of this title, or

(2) pursuant to any order issued under section 3363(b), (c), (d), or (g) of this title.

may be taken into account in applying any indefinite price escalator clause (as defined in section 3315(b)(3)(B) of this title).

§ 3374. Clauses prohibiting certain sales, transportation, and commingling

(a) General rule

Any provision of any contract for the first sale of natural gas is hereby declared against public policy and unenforceable with respect to any natural gas covered by this chapter if such provision—

(1) prohibits the commingling of natural gas subject to such contract with natural gas subject to the jurisdiction of the Commission under the provisions of the Natural Gas Act [15 U.S.C. 717 et seq.];

(2) prohibits the sale of any natural gas subject to such contract to, or transportation of any such natural gas by, any person subject to the jurisdiction of the Commission under the Natural Gas Act [15 U.S.C. 717 et seq.], or otherwise prohibits the sale or transportation in interstate commerce (within the meaning of the Natural Gas Act) of natural gas subject to such contract; or

(3) terminates, or grants any party the option to terminate, any obligation under any such contract as a result of such commingling, sale, or transportation.

(b) Natural gas covered by this chapter

For purposes of subsection (a) of this section, the term "natural gas covered by this chapter" means—

(1) natural gas which is not committed or dedicated to interstate commerce as of November 8, 1978;

(2) natural gas, the sale in interstate commerce of which—

(A) is authorized under section 3362(a) or 3371(b) of this title; or

(B) is pursuant to an assignment under section 3372(a) of this title; and,

(3) natural gas, the transportation in interstate commerce of which is—

(A) pursuant to any order under section 3362(c) or section 3363(b), (c), (d), or (h) of this title; or

(B) authorized by the Commission under section 3371(a) of this title.

§ 3375. Contract duration; filing of contracts and agreements

(a) Contract duration

(1) General rule

The Commission may, by rule or order, specify the minimum duration of any contract (other than any existing contract) for the purchase of natural gas to which section 3431(a)(1)(A) or (B) of this title is applicable. In no case may the minimum contract duration specified under this paragraph applicable to natural gas produced from any reservoir exceed 15 years or, if less, the commercially producible life of such reservoir.

(2) Nondiscriminatory application

(A) In general

Except as provided in subparagraph (B), the Commission may not exercise the authority provided under paragraph (1) in a manner which—

(i) provides an advantage to interstate pipelines by diverting supplies of natural gas to interstate pipelines and thereby denying adequate supplies of natural gas to intrastate pipelines; or

(ii) otherwise discriminates between purchases by interstate pipelines and intrastate pipelines of natural gas.

(B) Special circumstances

The Commission may vary any requirement established under paragraph (1) with respect to any contract by an interstate pipeline or intrastate pipeline to the extent necessary to respond to special circumstances.

(b) Filing of contracts and ancillary agreements

The Commission may, by rule or order, require any first sale purchaser of natural gas under a new contract, a successor to an existing contract, or a rollover contract to file with the Commission a copy of such contract, together with all ancillary agreements and any existing contract applicable to such natural gas.

§ 3391. Natural gas for essential agricultural uses

(a) General rule

Not later than 120 days after November 9, 1978, the Secretary of Energy shall prescribe and make effective a rule, which may be amended from time to time, which provides that, notwithstanding any other provision of law (other than subsection (b) of this section) and to the maximum extent practicable, no curtailment plan

of an interstate pipeline may provide for curtailment of deliveries of natural gas for any essential agricultural use, unless such curtailment—

(1) does not reduce the quantity of natural gas delivered for such use below the use requirement specified in subsection (c) of this section; or

(2) is necessary in order to meet the requirements of high-priority users.

(b) Curtailment priority not applicable if alternative fuel available

If the Commission, in consultation with the Secretary of Agriculture, determines, by rule or order, that use of a fuel (other than natural gas) is economically practicable and that the fuel is reasonably available as an alternative for any agricultural use of natural gas, the provisions of subsection (a) of this section shall not apply with respect to any curtailment of deliveries for such use.

(c) Determination of essential agricultural use requirements

The Secretary of Agriculture shall certify to the Secretary of Energy and the Commission the natural gas requirements (expressed either as volumes or percentages of use) of persons (or classes thereof) for essential agricultural uses in order to meet the requirements of full food and fiber production.

(d) Authority of Secretary of Agriculture to intervene

The Secretary of Agriculture may intervene as a matter of right in any proceeding before the Commission which is conducted in connection with implementing the re-

quirements of the rule prescribed under subsection (a) of this section.

(e) Limitation

The Secretary of Agriculture may not exercise any authority under this section for the purpose of restricting the production of any crop.

(f) Definitions

For purposes of this section—

(1) Essential agricultural use

The term "essential agricultural use", when used with respect to natural gas, means any use of natural gas—

(A) for agricultural production, natural fiber production, natural fiber processing, food processing, food quality maintenance, irrigation pumping, crop drying, or

(B) as a process fuel or feedstock in the production of fertilizer, agricultural chemicals, animal feed, or food.

which the Secretary of Agriculture determines is necessary for full food and fiber production.

(2) High-priority user

The term "high-priority user" means any person who—

(A) uses natural gas in a residence;

(B) uses natural gas in a commercial establishment in amounts of less than 50 Mcf on a peak day;

(C) uses natural gas in any school, hospital, or similar institution; or

(D) uses natural gas in any other use the curtailment of which the Secretary of Energy determines would endanger life, health, or maintenance of physical property.

§ 3391a. "Essential agricultural use" defined

For the purposes of section 3391 of this title, the term "essential agricultural use" shall—

(1) include use of natural gas in sugar refining for production of alcohol;

(2) include use of natural gas for agricultural production on set-aside acreage or acreage diverted from the production of a commodity (as provided under the Agricultural Act of 1949 [7 U.S.C. 1421 et seq] to be devoted to the production of any commodity for conversion into alcohol or hydrocarbons for use as motor fuel or other fuels; and

(3) for the 5-year period beginning on June 30, 1980, include use of natural gas in the distillation of fuel-grade alcohol from food grains or other biomass by facilities in existence on June 30, 1980, which do not have the installed capability to burn coal lawfully.

§ 3392. Natural gas for essential industrial process and feedstock uses

(a) General rule

The Secretary of Energy shall prescribe and make

effective a rule which provides that, notwithstanding any other provision of law (other than subsection (b) of this section) and to the maximum extent practicable, no interstate pipeline may curtail deliveries of natural gas for any essential industrial process or feedstock use, unless such curtailment—

(1) does not reduce the quantity of natural gas delivered for such use below the use requirement specified in subsection (c) of this section;

(2) is necessary in order to meet the requirements of high-priority users; or

(3) is necessary in order to meet the requirements for essential agricultural uses of natural gas for which curtailment priority is established under section 3391 of this title.

(b) Curtailment priority applicable only if alternative fuel not available

The provisions of subsection (a) of this section shall apply with respect to any curtailment of deliveries for any essential industrial process or feedstock use only if the Commission determines that use of a fuel (other than natural gas) is not economically practicable and that no fuel is reasonably available as an alternative for such use.

(c) Determination of essential industrial use requirements

The Secretary of Energy shall determine and certify to the Commission the natural gas requirements (expressed either as volumes or percentages of use) of persons (or classes thereof) for essential industrial pro-

cess and feedstock uses (other than those referred to in section 3391(f)(1)(B) of this title).

(d) Definitions

For purposes of this section—

(1) Essential industrial process or feedstock use

The term "essential industrial process or feedstock use" means any use of natural gas in an industrial process or as a feedstock which the Secretary determines is essential.

(2) High-priority user

The term "high-priority user" has the same meaning as given such term in section 3391(f)(2) of this title.

§ 3393. Establishment and implementation of priorities

(a) Establishment of priorities

The Secretary of Energy shall prescribe the rules under sections 3391 and 3392 of this title pursuant to his authority under the Department of Energy Organization Act [42 U.S.C. 7101 et seq.] to establish and review priorities for curtailments under the Natural Gas Act [15 U.S.C. 717 et seq.].

(b) Implementation of priorities

The Commission shall implement the rules prescribed under sections 3391 and 3392 of this title pursuant to its authority under the Department of Energy Organization Act [42 U.S.C. 7101 et seq.] to establish, review, and enforce curtailments under the Natural Gas Act [15 U.S.C. 717 et seq.].

§ 3394. Limitation on revoking or amending certain pre-1969 certificates of public convenience and necessity

(a) General rule

The Commission may not, during the 10-year period beginning on November 9, 1978, revoke or amend any certificate of public convenience and necessity issued before January 1, 1969, under section 7 of the Natural Gas Act [15 U.S.C. 717f] for the transportation of natural gas owned by any electric utility except upon the application of the person to whom such certificate was issued.

(b) Commission curtailment authority

The limitation under subsection (a) of this section shall not affect the authority of the Commission to enforce any curtailment of deliveries of natural Gas under the Natural Gas Act [15 U.S.C. 717 et seq.].

§ 3411. General rulemaking authority

(a) In general

Except where expressly provided otherwise, the Commission shall administer this chapter. The Commission, or any other Federal officer or agency in which any function under this chapter is vested or delegated, is authorized to perform any and all acts (including any appropriate enforcement activity), and to prescribe, issue, amend, and rescind such rules and orders as it may find necessary or appropriate to carry out its functions under this chapter.

(b) Authority to define terms

Except where otherwise expressly provided, the Commission is authorized to define, by rule, accounting, technical, and trade terms used in this chapter. Any such definition shall be consistent with the definitions set forth in this chapter.

(c) Delegation of certain determinations

The Commission may delegate to any State agency (with the consent of such agency) any of its functions with respect to sections 3315, 3316(b), and 3319(a)(1) and (3) of this title.

§ 3412 Administrative procedure

(a) Administrative Procedure Act

Subject to subsection (b) of this section, the provisions of subchapter II of chapter 5 of title 5 shall apply to any rule or order issued under this chapter having the applicability and effect of a rule as defined in section 551(4) of title 5; except that sections 554, 556, and 557 of such title 5 shall not apply to any order under such section 3361, 3362, or 3363 of this title.

(b) Opportunity for oral presentations

To the maximum extent practicable, an opportunity for oral presentation of data, views, and arguments shall be afforded with respect to any proposed rule or order described in subsection (a) of this section (other than an order under section 3361, 3362, or 3363 of this title). To the maximum extent practicable, such opportunity shall be afforded before the effective date of such rule or order. Such opportunity shall be afforded

no later than 30 days after such date in the case of a waiver of the entire comment period under section 553 (d)(3) of title 5, and no later than 45 days after such date in all other cases. A transcript shall be made of any such oral presentation.

(c) Adjustments

The Commission or any other Federal officer or agency authorized to issue rules or orders described in subsection (a) of this section (other than an order under section 3361, 3362, or 3363 of this title) shall, by rule, provide for the making of such adjustments, consistent with the other purposes of this chapter, as may be necessary to prevent special hardship, inequity, or an unfair distribution of burdens. Such rule shall establish procedures which are available to any person for the purpose of seeking an interpretation, modification, or rescission of, exception to, or exemption from, such applicable rules or orders. If any person is aggrieved or adversely affected by the denial of a request for adjustment under the preceding sentence, such person may request a review of such denial by the officer or agency and may obtain judicial review in accordance with section 3416 of this title when such denial becomes final. The officer or agency shall, by rule, establish procedures, including an opportunity for oral presentation of data, views, and arguments, for considering requests for adjustment under this subsection.

(d) Procedures applicable for incremental pricing determinations respecting imports

Notwithstanding the preceding provisions of this section, any determination made under section 3347(c)

of this title shall be made in accordance with the procedures applicable to the granting of any authority under the Natural Gas Act [15 U.S.C. 717 et seq.] to import natural gas or liquefied natural gas (as the case may be).

§ 3413. Determinations for qualifying under certain categories of natural gas

(a) General rule

(1) Determination

If any State or Federal agency makes any final determination which it is authorized to make under subsection (c) of this section for purposes of—

(A) applying the definition of new natural gas under section 3312(c) of this title;

(B) deciding if certain natural gas produced from the Outer Continental Shelf qualifies under section 3312(d) of this title for the new natural gas ceiling price;

(C) applying the definition of new, onshore production well under section 3313(c) of this title;

(D) applying the definition of high-cost natural gas under section 3317(c) of this title; or

(E) applying the definition of stripper well natural gas under section 3318(b) of this title;

such determination shall be applicable under this chapter for such purposes unless such determination is reversed under the provisions of subsection (b) of this section or unless such State or Federal agency

has waived its authority under the provisions of subsection (c) of this section.

(2) Notice to Commission

Any Federal or State agency making a determination under paragraph (1) shall provide timely notice in writing of such determination to the Commission. Such notice shall include such substantiation and be in such a manner as the Commission may, by rule, require.

(b) Commission review

(1) Authority to review and reverse

The Commission shall reverse any final State or Federal agency determination described in subsection (a) of this section if—

(A) it makes a finding that such determination is not supported by substantial evidence in the record upon which such determination was made; and

(B) such preliminary finding and notice thereof under paragraph (3) is made within 45 days after the date on which the Commission received notice of such determination under subsection (a)(2) of this section and the final such finding is made within 120 days after the date of the preliminary finding.

(2) Remand on basis of Commission information

If—

(A) the Commission finds that a State or Federal agency determination is not consistent with information contained in the public records

of the Commission, and which is not part of the record upon which such determination was made; and

(B) such preliminary finding and notice thereof under paragraph (3) is made within 45 days after the date on which the Commission received notice of such determination under subsection (a)(2) of this section and the final such finding is made within 120 days after the date of the preliminary finding.

it may remand the matter to such State or Federal agency for consideration of such information. If such agency, after consideration of the information transmitted to it by the Commission, affirms its previous determination, such determination, as so affirmed, shall be subject to review in accordance with this subsection (other than this paragraph).

(3) Notice

The Commission shall provide notice of any proposed finding under this subsection to the State or Federal agency which made such determination and those parties identified in the notice to the Commission of such determination.

(4) Judicial review of Commission actions

(A) Remands

Any party identified in the notice to the Commission of a determination by a State or Federal agency may obtain review of any final decision by the Commission to remand under paragraph (2) in the United States Court of Appeals for

any circuit in which such party is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia circuit. The reviewing court shall reverse any such decision if it finds such decision is arbitrary or capricious.

(B) Findings

Any person aggrieved or adversely affected by a final finding of the Commission under paragraph (1) may within 60 days thereafter file a petition for review of such finding in the United States Court of Appeals for any circuit in which the party involved in such determination is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia circuit. The reviewing court shall reverse any such finding of the Commission if the State or Federal agency determination involved is supported by substantial evidence.

(c) State authority

(1) General rule

A Federal or State agency having regulatory jurisdiction with respect to the production of natural gas is authorized to make determinations referred to in subsection (a) of this section.

(2) Waiver

(A) In general

Any Federal or State agency may, in whole or in part waive its authority to make determinations referred to in subsection (a)(1) of this section

by entering into an agreement in accordance with subparagraph (B). If such agency executes such a waiver, the Commission shall, consistent with the agreement, make the determinations which would otherwise be made by such Federal or State agency until the earlier of—

(i) the expiration of the period specified in the agreement; or

(ii) the date such agency transmits to the Commission written notice that it terminates such waiver and assumes the authority to make determinations referred to in subsection (a)(1) of this section.

Any waiver, or termination of any waiver, shall not apply to any determination with respect to any petition therefor which is pending before such agency or the Commission (as the case may be) on the date on which such a waiver or revocation is made.

(B) Agreements

Any waiver under subparagraph (A) may be made only by a written agreement between the Federal or State agency involved and the Commission. Any such agreement shall set forth the terms and conditions applicable to such waiver.

(3) Procedures applicable

Determinations of a Federal or State agency referred to in subsection (a)(1) of this section shall be made in accordance with the procedures generally applicable to such agency for the making of such determinations or comparable determinations

under the provisions of Federal or State law, as the case may be, pursuant to which they exercise their regulatory jurisdiction. The Commission may prescribe the form and content of filings with a Federal or State agency in connection with determinations made under this section.

(4) Judicial review

Any such determination referred to in subsection (a)(1) of this section made in accordance with procedures described in paragraph (3) shall not be subject to judicial review under any Federal or State law except as provided under subsection (b) of this section.

(d) Effect of determinations

For purposes of this chapter—

(1) General rule

Any final determination referred to in subsection (a)(1) of this section made by a Federal or State agency (or by the Commission under subsection (c)(2) of this section) which relates to any natural gas and which is no longer subject to review by the Commission under this section or to judicial review shall thereafter be binding with respect to such natural gas. The preceding sentence shall not apply to any final determination—

(A) if in making such determination the Commission or such Federal or State agency relied on any untrue statement of a material fact; or

(B) if there was omitted a statement of material fact necessary in order to make the state-

ments made not misleading, in light of the circumstances under which they were made, to the Federal or State agency in making such final determination or to the Commission in reviewing such determination.

(2) Application of title 18

Any untrue statement or omission of material fact to a Federal or State agency upon which the Commission relied shall be deemed to be statement or entry under section 1001 of title 18.

(e) Interim collection of maximum lawful price

(1) Collection of section 3319 price

(A) General rule

Effective beginning on the first day of the first month beginning after November 9, 1978, a seller of natural gas which is produced from a new well may, in accordance with subparagraph (B), charge and collect the appropriate maximum lawful price under section 3319 of this title for any first sale of such natural gas.

(B) Requirements

A seller may charge and make collections under subparagraph (A) only in accordance with the following requirements:

(i) Sworn statement

Before any such collection is made, the seller shall file with the Commission and any Federal or State agency having authority to make determinations referred to in subsection (a)(1)

of this section, a written sworn statement that such natural gas is produced from a new well and that such seller believes in good faith that such natural gas is eligible under this chapter to be sold at a price not less than the appropriate maximum lawful price under section 3319 of this title.

(ii) Petition for determination

Within 90 days after November 9, 1978, the seller files a petition to such Federal or State agency for a determination under this section.

(iii) Collection subject to refund

Any such collection made by the seller pending a determination under this section shall be collected subject to a condition of refund, with interest, in the event it is determined by such Federal or State agency that the applicable maximum lawful price is lower than that provided under section 3319 of this title.

(2) Alternate interim collection authority

(A) General rule

Promptly after November 9, 1978, the Commission shall, by rule or order, provide one or more methods under which a seller of natural gas may, in accordance with requirements established, and for such period as may be prescribed, under such rule or order, charge and collect for any first sale of such natural gas the maximum lawful price under subchapter I of this chapter for which a petition is filed for a determination under this

section in any case in which such price exceeds the appropriate maximum lawful price under section 3319 of this title.

(B) Collection subject to refund

Any such collection made by the seller pending a determination under this section, shall be collected subject to a condition of refund, with interest. Such refund with interest shall be paid, in accordance with the rule under subparagraph (A), unless it is determined under this chapter that the applicable maximum lawful price is equal to or greater than that collected. In addition, such seller shall comply with such requirements as the Commission shall prescribe in the applicable rule or order to provide adequate assurance that funds, to the extent attributable to a price in excess of the appropriate maximum lawful price under subchapter I of this chapter are available in the event of such refund.

(3) Collection after initial determination

(A) General rule

Effective beginning on the date of the notice of a determination under subsection (a)(2) of this section, a seller of natural gas covered by such determination may, in accordance with subparagraph (B), charge and collect the appropriate maximum lawful price applicable under such determination.

(B) Requirements

A seller may charge and make collections under subparagraph (A) if such collection is subject

to conditions prescribed by the Commission to assure refund, with interest, in the event it is determined under this chapter that the applicable maximum lawful price is lower than that provided under section 3319 of this title.

§ 3414. Enforcement

(a) General rule

It shall be unlawful for any person—

(1) to sell natural gas at a first sale price in excess of any applicable maximum lawful price under this chapter; or

(2) to otherwise violate any provision of this chapter or any rule or order under this chapter.

(b) Civil enforcement

(1) In general

Except as provided in paragraphs (2) and (3), whenever it appears to the Commission that any person is engaged or about to engage in any act or practice which constitutes or will constitute a violation of any provision of this chapter, or of any rule or order thereunder, the Commission may bring an action in the District Court of the United States for the District of Columbia or any other appropriate district court of the United States to enjoin such act or practice and to enforce compliance with this chapter, or any rule or order thereunder.

(2) Enforcement of emergency orders

Whenever it appears to the President that any person has engaged, is engaged, or is about to

engage in acts or practices constituting a violation of any order under section 3362 of this title or any order or supplemental order issued under section 3363 of this title, the President may bring a civil action in any appropriate district court of the United States to enjoin such acts or practices.

(3) Enforcement of incremental pricing

The Secretary, the Commission, or, on the request of the Secretary of Energy or the Commission, the Attorney General, may institute a civil action for injunctive or other equitable relief as may be appropriate to assure compliance with the provisions of section 3345 of this title requiring the passthrough of surcharges paid under section 3344 of this title by any local distribution company with respect to natural gas delivered to incrementally priced industrial facilities served by such company. Such action may be instituted in any district court of the United States in the State in which such local distribution company conducts business or in the District Court of the United States for the District of Columbia.

(4) Relief available

In any action under paragraph (1), (2), or (3), the court shall, upon a proper showing, issue a temporary restraining order or preliminary or permanent injunction without bond. In any such action, the court may also issue a mandatory injunction commanding any person to comply with any applicable provision of law, rule, or order, or ordering such other legal or equitable relief as the court determines appropriate, including refund or restitution.

(5) Criminal referral

The Commission may transmit such evidence as may be available concerning any acts or practices constituting any possible violations of the Federal antitrust laws to the Attorney General who may institute appropriate criminal proceedings.

(6) Civil penalties

(A) In general

Any person who knowingly violates any provision of this chapter, or any provision of any rule or order under this chapter, shall be subject to—

(i) except as provided in clause (ii) a civil penalty, which the Commission may assess, of not more than $5,000 for any one violation; and

(ii) a civil penalty, which the President may assess, of not more than $25,000, in the case of any violation of an order under section 3362 of this title or an order or supplemental order under section 3363 of this title.

(B) "Knowing" defined

For purposes of subparagraph (A) the term "knowing" means the having of—

(i) actual knowledge; or

(ii) the constructive knowledge deemed to be possessed by a reasonable individual who acts under similar circumstances.

(C) Each day separate violation

For purposes of this paragraph, in the case of

a continuing violation, each day of violation shall constitute a separate violation.

(D) Statute of limitations

No person shall be subject to any civil penalty under this paragraph with respect to any violation occurring more than 3 years before the date on which such person is provided notice of the proposed penalty under subparagraph (E). The preceding centence shall not apply in any case in which an untrue statement of material fact was made to the Commission or a State or Federal agency by, or acquiesced to by, the violator with respect to the acts or omissions constituting such violation, or if there was omitted a material fact necessary in order to make any statement made by, or acquiesced to by, the violator with respect to such acts or omissions not misleading in light of circumstances under such statement was made.

(E) Assessed by Commission

Before assessing any civil penalty under this paragraph, the Commission shall provide to such person notice of the proposed penalty. Following receipt of notice of the proposed penalty by such person, the Commission shall, by order, assess such penalty.

(F) Judicial review

If the civil penalty has not been paid within 60 calendar days after the assessment order has been made under subparagraph (E), the Commission shall institute an action in the appropriate district court of the United States for an order affirming

the assessment of the civil penalty. The court shall have authority to review de novo the law and the facts involved, and shall have jurisdiction to enter a judgment enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part, such assessment.

(c) Criminal penalties

(1) Violations of chapter

Except in the case of violations covered under paragraph (3), any person who knowingly and willfully violates any provision of this chapter shall be subject to—

(A) a fine of not more than $5,000; or

(B) imprisonment for not more than two years; or

(C) both such fine and such imprisonment.

(2) Violation of rules or orders generally

Except in the case of violations covered under paragraph (3), any person who knowingly and willfully violates any rule or order under this chapter (other than an order of the Commission assessing a civil penalty under subsection (b)(4)(E) of this section), shall be subject to a fine of not more than $500 for each violation.

(3) Violations of emergency orders

Any person who knowingly and willfully violates an order under section 3362 of this title or an order or supplemental order under section 3363 of this title shall be fined not more than $50,000 for each violation.

(4) Each day separate violation

For purposes of this subsection, each day of violation shall constitute a separate violation.

(5) "Knowingly" defined

For purposes of this subsection, the term "knowingly", when used with respect to any act or omission by any person, means such person—

(A) had actual knowledge; or

(B) had constructive knowledge deemed to be possessed by a reasonable individual who acts under similar circumstances.

§ 3415. Intervention

(a) Authority to intervene

(1) Intervention as matter of right

The Secretary of Energy may intervene as a matter of right in any proceeding relating to the prorationing of, or other limitations upon, natural gas production which is conducted by any State agency having regulatory jurisdiction over the production of natural gas.

(2) Enforcement of right to intervene

The Secretary may bring an action in any appropriate court of the United States to enforce his right to intervene under paragraph (1).

(3) Access to information

As an intervenor in a proceeding described in subsection (a) of this section, the Secretary shall have

access to information available to other parties to the proceeding if such information is relevant to the issues to which his participation in such proceeding relates. Such information may be obtained through reasonable rules relating to discovery of information prescribed by the State agency.

(b) Access to State courts

(1) Review in State courts

The Secretary may obtain review of any determination made in any proceeding described in subsection (a)(1) of this section in the appropriate State court if the Secretary intervened or otherwise participated in the original proceeding or if State law otherwise permits such review.

(2) Participation as amicus curiae

In addition to his authority to obtain review under paragraph (1), the Secretary may also participate an amicus curiae in any judicial review of any proceeding described in subsection (a)(1) of this section.

§ 3416. Judicial review

(a) Orders

(1) In general

The provisions of this subsection shall apply to judicial review of any order, within the meaning of section 551(6) of title 5 (other than an order assessing a civil penalty under section 3414(b)(4) of this title or any order under section 3362 of this title or any order under section 3363 of this title), issued under this chapter and to any final agency action

under this chapter required to be made on the record after an opportunity for an agency hearing.

(2) Rehearing

Any person aggrieved by any order issued by the Commission in a proceeding under this chapter to which such person is a party may apply for a rehearing within 30 days after the issuance of such order. Any application for rehearing shall set forth the specific ground upon which such application is based. Upon the filing of such application, the Commission may grant or deny the requested rehearing or modify the original order without further hearing. Unless the Commission acts upon such application for rehearing within 30 days after it is filed, such application shall be deemed to have been denied. No person may bring an action under this section to obtain judicial review of any order of the Commission unless—

(A) such person shall have made application to the Commission for rehearing under this subsection; and

(B) the Commission shall have finally acted with respect to such application.

For purposes of this section, if the Commission fails to act within 30 days after the filing of such application, such failure to act shall be deemed final agency action with respect to such application.

(3) Authority to modify orders

At any time before the filing of the record of a proceeding in a United States Court of Appeals,

pursuant to paragraph (4), the Commission may, after providing notice it determines reasonable and proper, modify or set aside, in whole or in part, any order issued under the provisions of this chapter.

(4) Judicial review

Any person who is a party to a proceeding under this chapter aggrieved by any final order issued by the Commission in such proceeding may obtain review of such order in the United States Court of Appeals for any circuit in which the party to which such order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia circuit. Review shall be obtained by filing a written petition, requesting that such order be modified or set aside in whole or in part, in such Court of Appeals within 60 days after the final action of the Commission on the application for rehearing required under paragraph (2). A copy of such petition shall forthwith be transmitted by the clerk of such court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to such order of the Commission shall be considered by the court if such objection was not urged before the Commission in the application for rehearing unless there was reasonable ground for the failure to do so. The finding of the

Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as the court deems proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and shall file with the court such modifed or new findings, which if supported by substantial evidence, shall be conclusive. The Commission shall also file with the court its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of title 28.

(5) Orders remain effective

The filing of an application for rehearing under paragraph 2 shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under paragraph (4) shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

(b) Review of rules and orders

Except as provided in subsections (a) and (c) of this section, judicial review of any rule or order, within the meaning of section 551(4) of title 5, issued under this chapter may be obtained in the United States Court of Appeals for any appropriate circuit pursuant to the provisions of chapter 7 of title 5, except that the second sentence of section 705 thereof shall not apply.

(c) Judicial review of emergency orders

Except with respect to enforcement of orders or subpenas under section 3364(a) of this title, the Temporary Emergency Court of Appeals, established pursuant to section 211(b) of the Economic Stabilization Act of 1970, as amended, shall have exclusive original jurisdiction to review all civil cases and controversies under section 3361, 3362 or 3363 of this title, including any order issued, or other action taken, under such section. The Temporary Emergency Court of Appeals shall have exclusive jurisdiction of all appeals from the district courts of the United States in cases and controversies arising under section 3364(a)(2) of this title; such appeals shall be taken by the filing of a notice of appeal with the Temporary Emergency Court of Appeals within thirty days after the entry of judgment by the district court. Prior to a final judgment, no court shall have jurisdiction to grant any injunctive relief to stay or defer the implementation of any order issued, or action taken, under section 3361, 3362, or 3363 of this title.

(d) Judicial review of certain incremental pricing determinations

Notwithstanding the preceding provisions of this section, any final determination made under section 3347(c)

of this title shall be subject to judicial review in accordance with the provisions of the Natural Gas Act [15 U.S.C. 717 et seq.] applicable to judicial review of any final determination respecting the grant or denial of any authority to import natural gas or liquefied natural gas.

§ 3417. Congressional review

(a) Application

This section applies with respect to—

(1) any disapproval by concurrent resolution of a Presidential reimposition of maximum lawful prices under section 3332 of this title;

(2) any congressional reimposition by concurrent resolution of maximum lawful prices under section 3332 of this title; and

(3) any resolution of disapproval relating to incremental pricing under section 3342(c) or 3346 (d)(2) of this title.

(b) Determination of calendar days of continuous session

In determining calendar days of continuous session for purposes of provisions of this chapter providing for disapproval under this section—

(1) continuity of session is broken only by an adjournment of Congress sine die; and

(2) the days on which either House is not in session because of an adjournment of more than 3 days to a day certain are excluded in the computation of the 30-calendar-day period involved.

If both Houses are not in session on the day any submittal subject to disapproval is received by the appropriate officers of each House, for purposes of this section such submittal shall be deemed to have been submitted on the first succeeding day on which both Houses are in session. If both Houses of the Congress do not receive a submittal on the same day, it shall not be considered to be received by either House until the day on which both Houses receive it.

(c) Resolution

For purposes of this section, and sections 3332, 3342, and 3346 of this title—

(1) Concurrent resolution disapproving reimposition of price ceilings

The term "concurrent resolution of disapproval", when used with respect to reimposition of maximum lawful prices under section 3332(c)(1) of this title, means a resolution the matter after the resolving clause of which is as follows: "That the Congress does not approve of the reimposition of maximum lawful prices for first sales of natural gas under section 122(c)(1) of the Natural Gas Policy Act of 1978 [15 U.S.C. 3332(c)(1)] pursuant to the transmittal by the President to the Congress on , 19 .", the blank spaces being filled with the appropriate date.

(2) Concurrent resolution effecting reimposition of price ceilings

The term "concurrent resolution", when used with respect to reimposition of maximum lawful prices under section 3332(c)(2) of this title, means

a resolution the matter after the resolving clause of which is as follows: That the Congress favors reimposition of maximum lawful prices for first sales of natural gas as provided for under section 122(c)(2) of the Natural Gas Policy Act of 1978 [15 U.S.C. 3332(c)(2)]".

(3) Resolution of disapproval of incremental pricing action

The term "resolution of disapproval", when used with respect to incremental pricing rules, means a resolution the matter after the resolving clause of which is as follows: "That the does not approve the proposed rule under section of the Natural Gas Policy Act of 1978 [15 U.S.C. 3301 et seq.] (relating to incremental pricing of natural gas) a copy of which was transmitted to the Congress on .", the first blank being filled with the House in which such resolution is introduced, the second blank space being filled with the section under which proposed rule was issued, and the following blank spaces being filled with the appropriate date. For purposes of this paragraph, the term "rule" means any rule or any amendment thereto (other than a technical or clerical amendment).

(d) Expedited procedure

(1) Congressional rulemaking power

This subsection is enacted by Congress—

(A) as an exercise of the rulemaking power of the Senate and the House of Representatives, respectively, and as such it is deemed a part

of the rules of each House, respectively, but applicable only with respect to the procedure to be followed in that House in the case of resolutions described by paragraph (2) of this subsection; and it supersedes other rules only to the extent that it is inconsistent therewith; and

(B) With full recognition of the constitutional right of either House to change the rules (so far as relating to the procedure of that House) at any time, in the same manner and to the same extent as in the case of any other rule of the House.

(2) Referral

A resolution described by paragraph (2) once introduced with respect to any submittal shall immediately be referred to a committee (and all resolutions with respect to the same submittal shall be referred to the same committee) by the President of the Senate or the Speaker of the House of Representatives, as the case may be.

(3) Discharge

(A) In general

If the committee to which a resolution with respect to a submittal has been referred has not reported it at the end of 20 calendar days after its referral, it shall be in order to move either to discharge the committee from further consideration of such resolution or to discharge the committee from further consideration of any other resolution with respect to such submittal which has been referred to the committee.

(B) Motions

A motion to discharge may be made only by an individual favoring the resolution, shall be highly privileged (except that it may not be made after the committee has reported a resolution with respect to the same submittal) and debate thereon shall be limited to not more than one hour, to be divided equally between those favoring and those opposing the resolution. An amendment to the motion shall not be in order, and it shall not be in order to move to reconsider the vote by which the motion was agreed to or disagreed to.

(C) Renewal

If the motion to discharge is agreed to or disagreed to, the motion may not be renewed, nor may another motion to discharge the committee be made with respect to any other resolution with respect to the same submittal.

(4) Floor consideration

(A) Motion to consider

When the committee has reported, or has been discharged from further consideration of, a resolution, it shall be at any time thereafter in order (even though a previous motion to the same effect has been disagreed to) to move to proceed to the consideration of the resolution. The motion shall be highly privileged and shall not be debatable. An amendment to the motion shall not be in order, and it shall not be in order to move

to reconsider the vote by which the motion was agreed to or disagreed to.

(B) Debate and consideration

Debate on the resolution referred to in subparagraph (A) of this paragraph shall be limited to not more than 10 hours, which shall be divided equally between those favoring and those opposing such resolution. A motion further to limit debate shall not be debatable. An amendment to, or motion to recommit, the resolution shall not be in order, and it shall not be in order to move to reconsider the vote by which such resolution was agreed to or disagreed to.

(6) Determination on motions

(A) Motions to postpone or to proceed to other business

Motions to postpone, made with respect to the discharge from committee, or the consideration of a resolution and motions to proceed to the consideration of other business, shall be decided without debate.

(B) Appeals from the decision of the Chair

Appeals from the decision of the Chair relating to the application of the rules of the Senate or the House of Representatives, as the case may be, to the procedure relating to a resolution shall be decided without debate.

(7) Subsequent action

Notwithstanding any of the provisions of this subsection, if a House has approved a resolution

with respect to a submittal, then it shall not be in order to consider in that House any other resolution with respect to the same such submittal.

§ 3418. Applicability of other Federal statutory provisions relating to information-gathering

In order to obtain information for the purpose of carrying out its functions under this chapter, the Commission shall have the same authority as is vested in the Secretary under 7151(a) of title 42 with respect to the exercise of authority under section 796(b) of this title and section 772(b), (c), and (d) of this title.

§ 3431. Coordination with the Natural Gas Act

(a) Jurisdiction of the Commission under the Natural Gas Act

(1) Sales

(A) Natural gas not committed or dedicated

For purposes of section 1(b) of the Natural Gas Act [15 U.S.C. 717(b)], effective on the first day of the first month beginning after November 9, 1978, the provisions of the Natural Gas Act [15 U.S.C. 717 et seq.] and the jurisdiction of the Commission under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of November 8, 1978, solely by reason of any first sale of such natural gas.

(B) Committed or dedicated natural gas

Effective beginning on the first day of the first month beginning after November 9, 1978, for

purposes of section 1(b) of the Natural Gas Act [15 U.S.C. 717(b)], the provisions of such Act [15 U.S.C. 717 et seq.] and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of November 8, 1978, and which is—

(i) high-cost natural gas (as defined in section 3317(c)(1), (2), (3), or (4) of this title);

(ii) new natural gas (as defined in section 3312(c) of this title); or

(iii) natural gas produced from any new, onshore production well (as defined in section 3313(c) of this title).

(C) Authorized sales or assignments

For purposes of section 1(b) of the Natural Gas Act [15 U.S.C. 717(b)], the provisions of the Natural Gas Act [15 U.S.C. 717 et seq.] and the jurisdiction of the Commission under such Act shall not apply by reason of any sale of natural gas—

(i) authorized under section 3362(a) or 3371(b) of this title; or

(ii) pursuant to any assigned authorized under section 3372(a) of this title.

(D) Natural-gas company

For purposes of the Natural Gas Act [15 U.S.C. 717 et seq.], the term "natural-gas com-

pany" (as defined in section 2(6) of such Act [15 U.S.C. 717a(6) et seq.]) shall not include any person by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B), or (C) of this paragraph.

(E) Alaskan natural gas

Subparagraph (B)(ii) and (iii) shall not apply with respect to natural gas produced from the Prudhoe Bay unit of Alaska and transported through the transportation system approved under the Alaska Natural Gas Transportation Act of 1976 [15 U.S.C. 719 et seq.].

(2) Transportation

(A) Jurisdiction of the Commission

For purposes of section 1(b) of the Natural Gas Act [15 U.S.C. 717(b)] the provisions of such Act [15 U.S.C. 717 et seq.] and the jurisdiction of the Commission under such Act shall not apply to any transportation in interstate commerce of natural gas if such transportation is—

(i) pursuant to any order under section 3362(c) or section 3363(b), (c), (d), or (h) of this title; or

(ii) authorized by the Commission under section 3371(a) of this title.

(B) Natural-gas company

For purposes of the Natural Gas Act [15 U.S.C.

717 et seq.], the term "natural-gas company" (as defined in section 2(6) of such Act [15 U.S.C. 717a(6)]) shall not include any person by reason of, or with respect to, any transportation of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission under the Natural Gas Act do not apply to such transportation by reason of subparagraph (A) of this paragraph.

(b) Charges deemed just and reasonable

(1) Sales

(A) First sales

Subject to paragraph (4), for purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid in any first sale of natural gas shall be deemed to be just and reasonable if—

(i) such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter; or

(ii) there is no applicable maximum lawful price solely by reason of the elimination of price controls pursuant to part B of subchapter I of this chapter.

(B) Emergency sales

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid in any sale authorized under section 3362(a) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and

equitable price established under such section and applicable to such sale.

(C) Sales by intrastate pipelines

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d] any amount paid in any sale authorized by the Commission under section 3371(b) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established by the Commission and applicable to such sale.

(D) Assignments

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid pursuant to the terms of any contract with respect to that portion of which the Commission has authorized an assignment authorized under section 3372(a) of this title shall be deemed to be just and reasonable if such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter.

(E) Affiliated entities limitation

For purposes of paragraph (1), in the case of any first sale between any interstate pipeline and any affiliate of such pipeline, any amount paid in any first sale shall be deemed to be just and reasonable if, in addition to satisfying the requirements of such paragraph, such amount does not exceed the amount paid in comparable first sales between persons not affiliated with such interstate pipeline.

(2) Other charges

(A) Allocation

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid by any interstate pipeline for transportation, storage, delivery or other services provided pursuant to any order under section 3363(b), (c), or (d) of this title shall be deemed to be just and reasonable if such amount is prescribed by the President under section 3363(h)(1) of this title.

(B) Transportation

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid by any interstate pipeline for any transportation authorized by the Commission under section 3371(a) of this title shall be deemed to be just and reasonable if such amount does not exceed that approved by the Commission under such section.

(c) Guaranteed passthrough

(1) Certificate may not be denied based upon price

The Commission may not deny, or condition the grant of, any certificate under section 7 of the Natural Gas Act [15 U.S.C. 717f] based upon the amount paid in any sale of natural gas, if such amount is deemed to be just and reasonable under subsection (b) of this section.

(2) Recovery of just and reasonable prices paid

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], the Commission

may not deny any interstate pipeline recovery of any amount paid with respect to any purchase of natural gas if—

(A) under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act [15 U.S.C. 717c, 717d], and

(B) such recovery is not inconsistent with any requirement of any rule under section 3341 of this title (including any amendment under section 3342 of this title),

except to the extent that Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds.

§ 3442. Effect on State laws

(a) Authority to prescribe lower maximum lawful prices

Nothing in this chapter shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under subchapter I of this chapter.

(b) Common carriers

No person shall be subject to regulation as a common carrier under any provision of Federal or State law by reason of any transportation—

(1) pursuant to any order under section 3362(c) or section 3363(b), (c), (d), or (i) of this title; or

(2) authorized by the Commission under section 3371(a) of this title.

28 U.S.C. § 1257

§ 1257. State courts; appeal; certiorari

Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court as follows:

(1) By appeal, where is drawn in question the validity of a treaty or statute of the United States and the decision is against its validity.

(2) By appeal, where is drawn in question the validity of a statute of any state on the ground of its being repugnant to the Constitution, treaties or laws of the United States, and the decision is in favor of its validity.

(3) By writ of certiorari, where the validity of a treaty or statute of the United States is drawn in question or where the validity of a State statute is drawn in question on the ground of its being repugnant to the Constitution, treaties or laws of the United States, or where any title, right, privilege or immunity is specially set up or claimed under the Constitution, treaties or statutes of, or commission held or authority exercised under, the United States.

RAILROAD COMMISSION OF TEXAS
GAS MARKET DEMAND RULE
15 Tex. Admin. Code §§ 3.30 and 3.34

§ 3.34

RULE 34. GAS TO BE PRODUCED AND PURCHASED RATABLY (Adopted by Order Effective September 1, 1986, and Amended by Orders Effective October 10, 1986, November 17, 1986, December 15, 1986, March 2, 1987, March 30, 1987, August 17, 1987, and November 3, 1987.)

(a) This section is promulgated to promote and maintain ratable production of natural gas and to require production in compliance with priority categories established by the commission, for the purposes of preventing waste including production in excess of market demand, protecting correlative rights, preventing discrimination and conserving the natural resources of this state. An operator shall not produce in excess of its ratable share of the market demand as determined by this section and §§ 3.28, 3.30, and 3.31 of this title (relating to Potential and Deliverability of Gas Wells to be Ascertained and Reports, Gas Nominations Required, and Gas Well Allowables) (Statewide Rules 28, 30 and 31). An operator shall produce ratably as set out in subsection (b) of this section and shall produce in compliance with subsection (f) of this section, which establishes priority categories of natural gas. Because production is dictated by pipeline capacity and market demand, pipelines are an integral part of production regulation. The requirements imposed on pipelines by this section and §§ 3.28, 3.30, and 3.31

of this title (relating to Potential and Deliverability of Gas Wells to be Ascertained and Reported, Gas Nominations Required, and Gas Well Allowables) (Statewide Rules 28, 30 and 31) are enforced to assist in the regulation of production and provide the only method by which such production regulation can be enforced and market demand met as required by statutory law. A first purchaser shall not discriminate between different wells from which it purchases in the same field, nor shall it discriminate unjustly or unreasonably between separate fields. The provisions of this section requiring ratable production and purchasing of gas apply to purchases and production from wells from which a first purchaser is purchasing on its pipeline system as defined in § 3.30 (a)(4) of this title (relating to Gas Nominations Required) (Statewide Rule 30).

(b) An operator shall produce without discrimination between its wells in the same field on the same first purchaser's pipeline system and without unjust or unreasonable discrimination between its wells in separate fields on the same first purchaser's pipeline system. An operator shall apportion a first purchaser's delivery requests ratably to its wells in each field on the same first purchaser's pipeline system without discrimination in the same manner as provided in this section and §§ 3.28, 3.30 and 3.31 of this title (relating to Potential and Deliverability of Gas Wells to be Ascertained and Reported, Gas Nominations Required, and Gas Well Allowables) (Statewide Rules 28, 30 and 31) and shall not produce in excess of its ratable share of the market demand as its share is determined by those rules. An operator shall produce in compliance with the priority categories of gas production established by the commission in subsection (f) of this section.

(c) In making purchases and accepting deliveries between fields, a first purchaser of natural gas that purchases and accepts delivery of gas from more than one field on its same pipeline system must accept from each field a consistent percentage of the portion of the aggregate deliverability and total gas limits that it is entitled to purchase from all wells from which it purchases on its pipeline system, unless the purchaser can demonstrate a just and reasonable basis for discriminating between fields. Natural gas purchases from a well by a first purchaser that uses another first purchaser's pipeline system to transport its gas and sells the gas purchased on that pipeline system solely to the first purchaser that owns the transport pipeline must be treated as first purchases of gas by the first purchaser that owns the transport pipeline.

(d) In making purchases and accepting deliveries within fields, a first purchaser of natural gas that purchases and accepts delivery of gas from different gas wells in the same priority category (see subsection (f) of this section) in the same field on its same pipeline system shall purchase and accept from the wells from which it purchases in the field a consistent percentage of the portion that it is entitled to purchase of the maximum allowable that a well is entitled to under the field's allocation formula. If purchases and deliveries from different wells in the same field become nonratable, the first purchaser shall consider commission-assigned underproduction and overproduction to establish an appropriate pattern of purchases or acceptance of deliveries to restore ratability. Natural gas purchases from a well by a first purchaser that uses another first purchaser's pipeline system to transport its gas and sells the gas purchased on that pipeline system solely to the first purchaser than owns the transport pipeline must be treated as first purchases

of gas by the first purchaser that owns the transport pipeline. Purchases and deliveries of casinghead gas shall be based on the well's gas limit (see § 3.49 of this title relating to Gas-Oil Ratio) (Statewide Rule 49) as provided in subsection (e) of this section. Overproduction and underproduction of gas is administered by the provisions of § 3.31 of this title (relating to Gas Well Allowables) (Statewide Rule 31). A first purchaser shall not reduce purchases from a limited well (see § 3.31(f)(4) of this title relating to Gas Well Allowables) until all prorated gas wells from which it purchases in the field connected to its same pipeline system are ratably reduced to the assigned allowable of the limited well. Below that point, purchases from all prorated wells and limited wells should be reduced ratably by purchasing and accepting delivery of the same percentage of the portion that it is entitled to purchase of the maximum allowable established for the well by the field's allocation formula. If purchases and deliveries from different wells in the same field become nonratable, the first purchaser shall consider commission-assigned underproduction and overproduction in establishing an appropriate pattern of purchases or acceptances of deliveries to restore ratability. When purchases of gas described in subsection (f)(2) or (5) of this section are to be reduced, they shall be reduced ratably within each priority category.

(e) When purchases and deliveries of casinghead gas described in subsection (f)(1) or (3) of this section are to be reduced, each well's share of the reduction shall be calculated by multiplying the total reduction by the fractional share that each well's gas limit bears to the arithmetic sum of the aggregate gas limits of all wells in the field from which the first purchaser has been purchasing on its same pipeline system. In calculating it's

reduction of a well, a first purchaser shall use that portion of the gas limits that it is entitled to purchase. A well operating under net gas/oil ratio authority shall produce no more gas than its gas limit as it would be reduced by the above procedure absent the net gas/oil ratio authority.

(f) First purchasers of gas shall satisfy their pipeline system demand for gas by purchasing and accepting delivery of gas from the following priority categories in ascending numerical order. "Lower priority category gas" is gas from a higher numerical category. A first purchaser shall not within its pipeline system curtail gas from a priority category if the purchaser is purchasing and accepting delivery of lower priority category gas as a first purchaser on its same pipeline system. A first purchaser's purchases and acceptance of delivery of first, second or third priority category gas under an obligation to purchase and accept delivery from the tailgate of a plant processing gas to extract liquids, or from a gathering system that purchases from wells and is required by contract or by its physical connections to sell its gas entirely to the purchaser, whether or not these purchases are made as a first purchaser, shall not be curtailed if the first purchaser is purchasing and accepting delivery of lower priority category gas as a first purchaser on its same pipeline system. If curtailed, the curtailment must be ratable with like priority category gas which the first purchaser is purchasing and accepting delivery of from wells on its same pipeline system.

(1) First priority shall be given to casinghead gas produced from certified tertiary recovery project approved by the commission and secondary recovery projects involving water injection, gas injection or pressure maintenance approved by the commission to prevent waste.

(2) Second priority shall be given to gas from special allowable wells as defined in § 3.31(f)(5) of this title (relating to Gas Well Allowables) (Statewide Rule 31) granted special allowable status after the effective date of this section to prevent physical waste. Wells classified as special allowable wells pursuant to notice and hearing prior to the effective date of this section shall be given second priority unless a new determination is made that the special allowable status is not necessary to prevent physical waste.

(3) Third priority shall be given to the remainder of casinghead gas so that gas produced in association with oil production shall not be wastefully vented and oil production shall not be unnecessarily curtailed. Gas recovered from a landfill or sewage process shall also be given third priority.

(4) Fourth priority shall be given to gas from wells classified under § 3.49(b) of this title (relating to Gas-Oil Ratio) (Statewide Rule 49(b)), but only to the extent of one full allowable for multiple 49(b) wells.

(5) Fifth priority shall be given to gas from administrative special allowable wells as defined in § 3.31(f)(6) of this title (relating to Gas Well Allowables) (Statewide Rule 31), to gas from special allowable wells (see § 3.31 (f)(5) of this title) (relating to Gas Well Allowables) granted that status prior to the effective date of this section (see paragraph (2) of this subsection) without notice and hearing, and to gas from special allowable wells granted that status by the commission subsequent to the effective date of this section after notice and hearing for other reasons than to prevent physical waste.

(6) Sixth priority shall be given to the remainder of

gas well gas, including limited wells (see subsection (d) of this section).

(g) A first purchaser of natural gas may not discriminate between or against natural gas of a similar kind or quality in favor of its own production or production in which it may be directly or indirectly interested in whole or in part.

(h) If a first purchaser elects to qualify an affiliate as a separate first purchaser in § 3.30(a)(1) of this title (relating to Gas Nominations required) (Statewide Rule 30), the first purchaser may designate the affiliate as a special marketing program. The special marketing program must comply with the following with respect to the nomination, purchase and acceptance of delivery of natural gas:

(1) For purposes of this subsection, an "affiliated first purchaser" is the special marketing program purchaser's affiliate whose pipeline is being used to transport the gas in the special marketing program.

(2) Each and every special marketing program offer to purchase gas must be made without discrimination within a field and without unjust or unreasonable discrimination between fields to all operators for all wells on the pipeline system of the affiliated first purchaser from which the affiliated first purchaser has been purchasing and accepting delivery of gas as a first purchaser. The offer must also be made for all first, second and third priority category gas on the affiliated first purchaser's pipeline system which it has been purchasing and accepting for delivery under an obligation to purchase and accept delivery from the tailgate of a plant processing gas to extract liquids, or from a gathering system that purchases from wells and is

required by contract or by its physical connections to sell its gas entirely to the affiliated first purchaser, whether or not those purchases were made as a first purchaser.

(3) It is unreasonably discriminatory, and therefore prohibited, for the offer to purchase gas in the special marketing program, or for any release of gas for sale in the special marketing program to require release of any claims under any existing contract or require modification of any existing contract provisions other than a release of the gas for sale in the special marketing program or a requirement of a volume-for-volume basis for gas taken in the special marketing program to be credited against the contract from which gas is released for sale in the special marketing program, if the credit provision is limited to the period of actual participation in the special marketing program. Nothing in this paragraph shall prohibit an operator of any well from offering terms inconsistent with these provisions. The making of an offer which is not accepted shall not affect rights under existing contracts.

(4) If a well producing priority category 1, 2 or 3 gas is shut in or curtailed, and waste as defined in title 3 of the Texas Natural Resources Code is found by the commission to exist, neither a special marketing program purchaser nor its affiliated first purchaser may purchase lower priority category gas until all the priority category 1, 2 and 3 gas is taken and resulting waste is prevented. The commission shall expedite determination of waste, and may enter an emergency, temporary or interim order upon application and affidavit proof that waste is occurring. The application and affidavit proof must be accompanied by supporting documentation, including data on well performance, and a statement that the application and affidavit proof has been served on the first purchaser(s) of

the subject well(s) and any affiliated special marketing program purchaser using the first purchaser(s) same pipeline system on or before the date the application and affidavit proof has been mailed or delivered to the commission, with the opportunity for the first purchaser to respond within five days of service or of commission receipt, whichever is latest.

(5) The affiliated first purchaser must continue in compliance with this section and § 3.30 of this title (relating to Gas Nominations Required) (Statewide Rule 30) to nominate, purchase and accept delivery from the wells for which the offer was made and not accepted.

(6) With respect to the nomination and purchase of gas from those that accept an offer made pursuant to this subsection, the special marketing program purchaser must comply with this section and §§ 3.28, 3.30 and 3.31 of this title (relating to Potential and Deliverability of Gas Wells to be Ascertained and Reported, Gas Nominations Required, and Gas Well Allowables) (Statewide Rules 28, 30 and 31) as a separate first purchaser.

(7) It is not the objective of this subsection to abrogate any existing contract rights or obligations.

(i) Any operator or non-operator that is denied by the first purchaser in violation of this section or §§ 3.28, 3.30, or 3.31 of this title (relating to Potential and Deliverability of Gas Wells to be Ascertained and Reported, Gas Nominations Required, and Gas Well Allowables) (Statewide Rules 28, 30, and 31) the opportunity to produce a well's ratable share of gas or opportunity for a well to participate in a special marketing program may file a complaint with the commission and request the commission to direct the first purchaser to end the dis-

criminatory practices. A complainant may request a hearing regarding alleged discriminatory practices or to determine whether a first purchaser is or has through gas exchange agreements or through actions of its affiliate(s) denied an operator a reasonable opportunity to market its gas.

(j) If after reasonable notice by the purchaser, an operator fails to comply with a first purchaser's request to reduce production ratably in compliance with this section and §§ 3.28, 3.30, and 3.31 of this title (relating to Potential and Deliverability of Gas Wells to Be Ascertained and Reported, Gas Nominations Required, and Gas Well Allowables) (Statewide Rules 28, 30, and 31) the purchaser may file a complaint with the commission and request the commission to direct the operator to comply with the purchaser's requests to reduce production ratably. The complainant or the operator may request the commission to take further action, including setting the issue for hearing.

(k) If the operation of this section or §§ 3.28, 3.30, or 3.31 of this title (relating to Potential and Deliverability of Gas Wells to be Ascertained and Reported, Gas Nominations Required, and Gas Well Allowables) (Statewide Rules 28, 30, and 31) cause undue hardship, the commission may after proper notice and hearing grant an exception or take appropriate action, including action to prevent waste or correlative rights.

(l) If any provision of this section or its application to any person or circumstance is held invalid, the invalidity shall not affect other provisions or applications of the section which can be given effect without the invalid provision or application, and the provisions of the section are declared to be severable.

§ 3.30

RULE 30. GAS NOMINATIONS REQUIRED (As Amended by Orders Effective September 1, 1986, and March 2, 1987.)

(a) The following words and terms, when used in this section and in §§ 3.28, 3.31, and 3.34 of this title (relating to Potential and Deliverability of Gas Wells to be Ascertained and Reported, Gas Well Allowables and Gas to be Produced and Purchased Ratably) (Statewide Rules 28, 31 and 34) shall have the following meanings, unless the context clearly indicates otherwise.

(1) First Purchaser or Initial Purchaser - the first purchaser of natural gas produced from a well. A first purchaser and any affiliate of the purchaser that transports any natural gas it purchases from a well by use of the same pipeline system used by the first purchaser of which it is an affiliate shall be treated as a single first purchaser for purposes of nominations and ratability requirements; provided, however, that an affiliate that is nominating or purchasing and accepting deliveries pursuant to a special marketing program that is in compliance with § 3.34(h) of this title (relating to Gas to be Produced and Purchased Ratably), shall be treated as a separate first purchaser, and, provided further that the designation of such affiliate as a separate first purchaser is reviewable by the commission and may be disallowed upon a showing that the designation was for purposes of circumventing this section and § 3.34 (relating to Gas to be Produced and Purchased Ratably). Any affiliate may file forms in its own name.

(2) Downstream purchaser - One that purchases natural gas for resale and is not a first purchaser.

(3) Initial Nominator - First purchaser or the designated representative of the first purchaser.

(4) Pipeline System - A network of physically connected pipelines that are operated as a single unit under normal conditions. A first purchaser's pipeline system is that portion of a physical segment of a pipeline that the first purchaser owns. If a first purchaser does not own the pipeline it uses to transport its gas, the first purchaser's pipeline system shall include all the wells from which it purchases that are on the pipeline system of the transport pipeline. A first purchaser may not segregate its purchases from any one field into two or more pipeline systems by transporting on another pipeline gas that it purchases as a first purchaser if the first purchaser is also purchasing as a first purchaser from the same field and transporting on a pipeline that it owns. A first purchaser may not segregate its purchases from any one field into two or more pipeline systems by executing gas exchange agreements. Any of a first purchaser's pipeline systems which serve a common customer or common customers in a common geographic location shall be operated in a manner to avoid unjust or unreasonable discrimination in nominations and takes as between those systems. A first purchaser shall not segregate its physically connected pipelines that are capable of being operated as a single unit under normal conditions into two or more pipeline systems or designate a gathering system as a separate system for purposes of circumventing this section of § 3.34 (relating to Gas to be Produced and Purchased Ratably).

(5) Affiliate - A person or entity that owns, is owned by, or is under common ownership with another person or entity to the extent of 50% or more or that otherwise controls or is controlled by another person or entity.

Affiliates of a common entity are also affiliates of each other. For purposes of this section and §§ 3.28, 3.31, and 3.34 of this title (relating to Potential and Deliverability of Gas Wells to be Ascertained and Reported, Gas Well Allowables and Gas to be Produced and Purchased Ratably) (Statewide Rules 28, 31, and 34), a person or entity that purchases gas solely for purposes other than resale shall not be considered an affiliate, and an "interstate pipeline", as defined in section 2(15) of the Natural Gas Policy Act of 1978 (15 U.S.C. Sec. 3301 et seq.), shall not be considered an affiliate of an intrastate pipeline.

(b) A first purchaser shall on or before a date designated by the director of the oil and gas division or the director's delegate designate its pipeline system(s) pursuant to this section and shall identify its affiliates that use the same pipeline system and that are nominating under a different name, including an affiliate operating a special marketing program that is in compliance with § 3.34(h) of this title (relating to Gas to be Produced and Purchased Ratably) (Statewide Rule 34). A pipeline system designation must identify the physical segment of pipeline that constitutes the pipeline system and identify by Railroad Commission lease and/or identification number and field the wells on that pipeline system from which the first purchaser is purchasing. A change in pipeline system designation is not required to add or delete well connections. The designation of a pipeline system cannot be changed by a first purchaser without prior approval by the director of the oil and gas division or the director's delegate. Approval of a change in pipeline system designation cannot be given without prior notice of the requested designation given by the first purchaser to af-

fected operators of wells on the system(s) for which a change in designation is sought. A hearing to determine the proper designation of a first purchaser's pipeline system may be called by the commission, or may be requested by a first purchaser or by an operator filing a complaint. The burden of proof in the hearing shall be on the first purchaser.

(c) Any person who purchases natural gas at the wellhead, at a common point within a field or fields or at the outlet of a processing or treating plant must determine if it is the initial purchaser. If it is the initial purchaser, it shall file nominations as required by this section. An operator using 100% of the gas from a gas well or wells for his own operations, either on leases or in a fuel system, shall file gas nominations. An operator using a portion of the gas produced from a well must notify the initial nominator in writing of the volume or percentage of total volume required, including shrinkage due to liquid separation prior to sale. The initial nominator must include that amount in its nominations. After initial notification, the operator need only inform the initial nominator of changes in the volume or percentage of total volume required.

(d) So that the commission may determine market demand and set allowables for ratable production not exceeding market demand, initial nominators shall file in the appropriate commission office by the ninth day of each month nominations by pipeline system of requirements for gas to be purchased and/or used by them from each reservoir or field during the following month. Designated reperesentatives must file nominations in the name of first purchasers. By the fourth day of each month, an initial nominator shall inform each of the operators

from which it purchases of the amount it intends to nominate for that operator by field.

(e) Every nomination shall be equal to the anticipated market demand for gas on the pipeline system of the initial nominator for the month for which the nomination is made, and shall include the following:

(1) the quantity for which the operator and/or the initial purchaser are the ultimate consumers. This amount will include lease usage, shrinkage, line loss, plant fuel, compressor fuel, and the gas that the initial purchaser may consume prior to the point of final delivery;

(2) the total quantity of gas nominated by its downstream purchasers in accordance with the following provisions:

(A) All downstream purchasers that take more than 10 MMcf per day shall submit monthly to their initial or first nominators of gas a downstream purchaser's nomination based on a firm forecast of that purchaser's actual demand;

(B) If a downstream purchaser takes gas from more than one source of supply, that downstream purchaser's nomination shall show expected demand from each source;

(C) Written monthly nominations from downstream purchaser shall be kept on file by the initial nominator for a period of no less than two years for commission inspection and shall be filed with the commission on its request; and

(3) the remaining quantity of gas that the intial nominator expects to take for direct sale to end-users and any other volumes for which no nomination has been made under paragraphs (1) or (2) of this subsection.

(f) Nominations for a field by an initial nominator shall not exceed the deliverability available to that nomination from that field. The initial nominator shall within a pipeline system ratably apportion without unjust or unreasonable discrimination its nominations among the various fields from which it purchases gas. The nomination for each field shall be a consistent percentage of the total deliverability of all gas wells and the total gas limits of all oil wells from which it purchases from all fields on its pipeline system or other apportionment that the nominator can demonstrate will not result in unjust or unreasonable discrimination. In nominating for a well that has multiple first purchasers each first purchaser shall nominate a consistent percentage of that portion of the well's deliverability or the well's gas limit for casinghead gas that it has designated to the commission that it is entitled to purchase. The total nominations of the multiple first purchasers from a well shall not exceed the total deliverability or gas limit of the well. The nominator shall include the following on the nomination form:

(1) the nomination for each field as a volume of gas in Mcf, including gas purchases and gas consumed by the operator and/or the first purchaser (lease usage, shrinkage, line loss, plant fuel, compressor fuel and the gas that the initial purchaser may consume prior to the point of final delivery);

(2) the nomination in each field as a percentage of the aggregate deliverability and total gas limits it is entitled to purchase from all wells from which it purchases on its pipeline system;

(3) the nomination volume for each field on its pipeline system made for the third month preceding the due date of the current nomination; and

(4) the production volume actually taken from each field as a volume and as a percentage of total deliverability for each field for the third month preceding the due date of the current nomination on its pipeline system.

(g) Nominations by an initial nominator for gas within a pipeline system shall be made according to the following priorities, in order.

(1) First priority in the nominations for the purchase of gas shall be given to casinghead gas produced from certified tertiary recovery projects approved by the commission and secondary recovery projects involving water injection, gas injection or pressure maintenance approved by the commission to prevent waste.

(2) Second priority shall be given to gas from special allowable wells as defined in § 3.31(f)(5) of this title (relating to Gas Well Allowables) (Statewide Rule 31) granted special allowable status after the effective date of this section to prevent physical waste. Wells classified as special allowable wells prior to the effective date of this section pursuant to notice and hearing shall be given second priority unless a new determination is made that the special allowable status is not necessary to prevent physical waste.

(3) Third priority shall be given to the remainder of casinghead gas so that gas produced in association with oil production shall not be wastefully vented and oil production shall not be unnecessarily curtailed. Gas recovered from a landfill or sewage process shall also be given third priority.

(4) Fourth priority shall be given to gas from wells classified under § 3.49(b) of this title (relating to Gas-

Oil Ratio) (Statewide Rule 49(b)), but only to the extent of one full allowable for multiple 49(b) wells.

(5) Fifth priority shall be given to gas from administrative special allowable wells as defined in § 3.31(f)(6) of this title, (relating to Gas Well Allowables), to gas from special allowable wells (as defined in § 3.31(f)(5) of this title relating to Gas Well Allowables) granted that status prior to the effective date of this section (see paragraph (2) of this subsection) without notice and hearing, and to gas from special allowable wells granted that status by the Commission subsequent to the effective date of this section after notice and hearing for other reasons than to prevent physical waste.

(6) Sixth priority shall be given to the remainder of gas well gas.

(h) Curtailments of production and acceptance of deliveries of gas shall be performed in accordance with the provisions of § 3.34 of this title (relating to Gas to be Produced and Purchased Ratably) (Statewide Rule 34).

(i) If any provision of this section or its application to any person or circumstance is held invalid, the invalidity shall not affect other provisions or applications of the section which can be given effect without the invalid provision or application, and the provisions of the section are declared to be severable.

RULE 131. REQUISITES OF APPLICATIONS

The application for writ of error shall be adressed to "the Supreme Court of Texas," and shall state the name of the party or parties applying for the writ. The parties shall be designated as "Petitioner" and "Respondent." Applications for writs of error shall be as brief as possible. The respondent should file a brief in response. The application shall contain the following:

(a) Names of All Parties. A complete list of the names of all parties shall be listed on the first page of the application, so the members of the court may at once determine whether they are disqualified to serve or should recuse themselves from participation in the decision of the case.

(b) Table of Contents and Index of Authorities. The application shall contain at the front thereof a table of contents with page references where the discussion of each point relied upon may be found and also an index of authorities alphabetically arranged, together with reference to the pages of the application where the same are cited. The subject matter of each point or group of points shall be indicated in the table of contents.

(c) Statement of the Case. The application should contain a brief general statement of the nature of the suit, —for instance, whether it is a suit for damages, on a note, or in trespass to try title, and that the statement as contained in the opinion of the court of appeals is correct, except in the particulars pointed out. Example: "This is a suit for damages in excess of $1000.00 for personal injuries growing out of an automobile collision. The

opinion of the court of appeals correctly states the nature and results of the suit, except in the following particulars: (If any.)" Such statement should seldom exceed one-half page. The details of the case should be reserved to be stated in connection with the points to which they are pertinent.

(d) Statement of Jurisdiction. Except in those cases in which the jurisdiction of the court depends on a conflict of decisions under subsection (a)(2) of section 22.001 of the Government Code, the petition should merely state that the Supreme Court has jurisdiction under a particular subsection of section 22.001 of the Government Code. Example: "The Supreme Court has jurisdiction of this suit under subsection (a)(6) of section 22.001 of the Government Code." When jurisdiction of the Supreme Court depends on a conflict of decisions, the conflict on the question of law should be clearly and plainly stated.

(e) Points of Error. A statement of the points upon which the application is predicated shall be stated in short form without argument and be separately numbered. In parentheses after each point, reference shall be made to the page of the record where the matter complained of is to be found. Whether the matter complained of originated in the trial court or in the court of appeals, it shall be assigned as error in the motion for rehearing in the court of appeals. Points will be sufficient if they direct the attention of the court to the error relied upon. Complaints about several issues or findings relating to one element of recovery or defense may be combined in one point, if separate record references are made.

(f) Brief of the Argument. The brief of the argument may present separately, or grouped if germane, the points of error relied upon for reversal, the argument to include such pertinent statements from the record as may be requisite, together with page references and such discussion of the authorities as is deemed necessary to make clear the points of error complained of. The opinion of the court of appeals will be considered with the application, and statements therein, if accepted by counsel as correct, need not be repeated.

(g) Prayer for Relief. The nature of the relief sought by the application should be clearly stated.

(h) Amendment. The application may be amended at any time when justice requires upon such reasonable terms as the court may prescribe.

(i) Length of Application. An application shall not exceed 50 pages in length, exclusive of pages containing the table of contents, index of authorities, points of error, and any addendum containing statutes, rules, regulations, etc. The court may, upon motion and order, permit a longer brief.

(j) Court May Require Application Redrawn. If any brief or application for writ of error is unnecessarily lengthy or not prepared in conformity with these rules, the Supreme Court may require same to be redrawn.

Supreme Court, U.S.
FILED
JAN 8 1990
JOSEPH F. SPANIOL, JR.
CLERK

NO. 89-935

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants

VS.

VALERO TRANSMISSION COMPANY,
Appellee

FROM NO. 04-87-00380-CV
IN THE COURT OF APPEALS FOR THE
FOURTH SUPREME JUDICIAL DISTRICT OF TEXAS
AT SAN ANTONIO, BEXAR COUNTY, TEXAS

MOTION TO DISMISS APPEAL AND, ALTERNATIVELY, TO AFFIRM JUDGMENT

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January 6, 1990

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LIST OF COMPANIES AFFILIATED WITH VALERO TRANSMISSION COMPANY

Valero Transmission Company, formerly a corporation, has become a limited partnership, Valero Transmission, L.P. During the time it was a corporation, its parent corporation was Valero Energy Corporation. It had no subsidiary corporations. Corporations in any way affiliated with it were: -

Valero Coal Company
Valero Management Company
Valero Land Company
Valero Natural Gas Company
Valero Communications Company
Valero Realty Company
Valero Refining and Marketing Company
J & R Coal Company
ESCO Supply Company
Valero Building Company
Rio Grande Valley Gas Company
Valero Refining Company
Valero Petroleum Marketing Company
VMGA Company
Valero Interstate Transmission Company
Valero Investor Services, Inc.
Valero Eastex Pipeline Company
R.G.V. Consumer Service Company
Corpus Christi Marine Services Company
Valero Oil International, Ltd.
Rio Pipeline Company
Valero Storage Company
Valero Gas Storage Company
VLDC Company
Val Gas Company
V.H.C. Gas Systems Company
Mesquite Services Company
Valero Industrial Gas Company
Valero Hydrocarbons Company
Valero Marketing Company
V.H.C. Pipeline Company
Valero Gathering Company
Reata Industrial Gas Company

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MOTION TO DISMISS APPEAL AND, ALTERNATIVELY, TO AFFIRM JUDGMENT

To The Honorable United States Supreme Court:

Valero Transmission Company ("Valero"), appellee, files this Motion to Dismiss Appeal, and, Alternatively, to Affirm Judgment.

I. Overview

This case involves the state law question of whether Valero, an intrastate pipeline, breached a gas purchase contract with appellants Lively Exploration Company, et al. ("Lively"). Valero seeks dismissal of Lively's appeal for the following reasons: (i) the appeal cannot be taken in conformity with the amended 28 U.S.C. § 1257 (West Supp. 1989); (ii) the appeal is not within this Court's jurisdiction; (iii) the alleged "federal questions" were neither timely and properly raised nor expressly passed on; (iv) no federal question at all is presented, much less a substantial one; and (v) the court of appeals judgment rests on an adequate non-federal basis. Alternatively, Valero seeks affirmance of the court of appeals judgment.

II. This Appeal is Not Within this Court's Jurisdiction and Cannot be Taken in Accordance with Statute

This Court has no jurisdiction to consider this appeal, and it cannot be taken in accordance with 28 U.S.C. § 1257 (West Supp. 1989) ("§ 1257").

After the trial court entered judgment in this case against Lively, Lively appealed. On March 31, 1988, the court of appeals affirmed the trial court's judgment. (Lively's Appendix, pp. 36-37). Lively applied for a writ of error to the supreme court of Texas, which denied its application on June 7, 1989, and denied Lively's motion for rehearing on September 13, 1989. (Lively's Appendix, pp. 32-35).

Effective September 25, 1988, § 1257 was amended to eliminate an appeal for final judgments entered on

or after that date. The court of appeals judgment did not become final for jurisdiction purposes until the Texas supreme court denied rehearing on September 13, 1989. *Market St. Ry. v. Railroad Comm'n*, 324 U.S. 548, 551 (1945); *Chicago Great W. R.R. v. Basham*, 249 U.S. 164, 167 (1919); *Andrews v. Virginian Ry.*, 248 U.S. 272, 274-75 (1919). Therefore, Lively's appeal is foreclosed.

It is true that where the Texas supreme court has refused an application for writ of error, an appeal to the United States Supreme Court is properly from the court of civil appeals. *Michigan-Wisconsin Pipeline Co. v. Calvert*, 347 U.S. 157, 159 (1954). However, the date of the court of appeals judgment does not determine whether the amendment to § 1257 applies.

Review of a court of appeals judgment by the state supreme court must be sought before this Court has jurisdiction to review it. *Sandquist v. California*, 419 U.S. 1066 (1974); *Banks v. California*, 395 U.S. 708 (1969); *Stratton v. Stratton*, 239 U.S. 55, 56-57 (1915). To be "final" so as to give rise to this Court's jurisdiction, a judgment must be "subject to no further *review* or correction in *any other state tribunal*; . . . . [The judgment] must be the final word of a final court." *Market St. Ry.*, 324 U.S. at 551 (emphasis supplied). Until the Texas supreme court's denial of the motion for rehearing, the court of appeals judgment was "subject to . . . further review or correction [by another] state tribunal," *id.*, and therefore was not final for jurisdictional purposes.

Moreover, the time limit for applying to this Court for relief runs from the date the state supreme court refuses writ or rehearing, not from the date of the court

of appeals' decision. *United States v. Walter*, 44 S.Ct. 10, 12 (1923); *American Ry. Exp. v. Levee*, 263 U.S. 19, 20-21 (1923). Lively notes that it docketed its appeal "within 90 days from the denial of rehearing by the Texas Supreme Court" (Jurisdictional Statement, p. 3); this Court's then-applicable rules provided for docketing "90 days after the entry of the *judgment appealed from.*" Sup. Ct. R. 12, 28 U.S.C.A. 18 (1984). By necessarily equating the "denial of rehearing" with the "judgment appealed from," Lively illustrates that, for jurisdictional purposes, the court of appeals judgment cannot have been finally "entered" until denial of rehearing by the Texas supreme court.

Chicago Great W. R.R. and *Andrews* are closely on point. In *Chicago Great W. R.R.*, the Judicial Code then in effect, which governed review of state court decisions by this Court, had been amended to specifically delineate jurisdiction exercisable by writ of error as opposed to writ of certiorari. *Id.* at 165. The amendment provided that the right of review under existing laws with respect to judgments entered before the act took effect (October 6, 1916) should remain unaffected for the period of six months thereafter. *Id.* at 166. Within the six-month period, petitioner applied for a writ of error that did not come within this Court's jurisdiction under the Amendment. *Id.* at 165-66. Noting that whether its jurisdiction was properly raised "depends upon whether the judgment sought to be reviewed was 'entered before this act takes effect' within the meaning of [the amendment]," *id.*, this Court concluded the judgment could not be considered final until December 18, 1916, the date the state supreme court denied the second petition for rehearing:

> It is only a judgment marking the conclusion of the course of litigation in the courts of the state that is subject to our review. Hence, whatever its form of finality, if a judgment be in fact subject to reconsideration and review by the state court of last resort through the medium of a petition for rehearing, and such a petition is presented to and entertained and considered by that court, we must take it that by the practice prevailing in the state the litigation is not brought to a conclusion until this petition is disposed of, and until then the judgment previously rendered cannot be regarded as a final judgment within the meaning of the act of Congress.

Id. at 167. Therefore, the writ of error was dismissed. *Id.*

In *Andrews* this Court considered the same amendment and reached the same conclusion. Petitioner sought a writ of error to a trial court judgment that was rendered on June 16, 1916, but on which the court of appeals had denied writ of error on November 13, 1916. *Id.* at 273. Dismissing the subsequent writ of error for want of jurisdiction, this Court stated:

> Undoubtedly, before the action of the Court of Appeals, the judgment was not final and was susceptible of being reviewed and reversed by that court. Undoubtedly, also, until the Court of Appeals acted, the trial court was not the court of last resort of the state whose action could be here reviewed. The contention, therefore, that the judgment of the trial court was a final judgment susceptible of being here reviewed by writ of error must rest upon the impossible assumption that the finality of that judgment existed before the happening of the cause by which alone finality could be attributed to it.

Id. at 274. This Court noted that any other rule would render a judgment "open at the same time to the power of a state court to review and reverse, . . . depriving each court of its power" and possibly resulting in "conflict and confusion." *Id.* at 275.

The section-by-section analysis of Public Law 100-352, which revised § 1257, additionally makes clear that Lively's appeal is barred:

> Section 7 provides that this act shall become effective ninety days after enactment, but that the act shall not affect cases then pending in the Court or judgments or decrees *subject to appeal* that have been issued *prior* to the effective date of this act.

H.R. Rep. No. 660, 100th Congress, 2nd Sess. 12, *reprinted in* 1988 U.S. Code Cong. & Admin. News 766, 779 (emphasis supplied). The court of appeals judgment was not "subject to appeal" to this Court until state remedies had been exhausted.

In fact, the objective of the "highest state court" requirement of § 1257 is to insure that state remedies have been exhausted *before* resort to this Court may be had. *See, e.g., Costarelli v. Massachusetts,* 421 U.S. 193, 196 (1975).

Therefore, the amendment to § 1257 forecloses Lively's appeal.

III. Statement of the Case Relevant to Other Grounds for Dismissal

A. The Parties.

Valero is a public utility *intrastate* gas pipeline

company that purchases, transports, and sells natural gas throughout the State of Texas.

Lively is comprised of producers, operators, royalty interest owners, and sellers of oil and gas in Texas.

B. The Contract.

On February 12, 1973, Lively and Valero's predecessor-in-interest entered into a gas purchase contract ("Contract") for the sale of natural gas produced from Lively's properties in Sutton County, Texas. The Contract includes a "take-or-pay" provision:

> *Subject to the other provisions hereof,* Buyer agrees to purchase and pay for (or, *if Buyer's performance hereunder is not excused by other provisions of this agreement,* pay for, *if available,* whether taken or not) during the days of each Contract year . . . a *Daily Contract Quantity* of gas from Seller's Lands and Leases in the Contract Area equal to ninety percent (90%) of Seller's daily *Deliverability* of gas hereunder.

(Contract, art. V, § 5.3) (emphasis supplied).

The take-or-pay provision references two specific terms that are defined in the Contract and that operate with the take-or-pay clause to set forth Valero's take-or-pay obligations: "Daily Contract Quantity" ("DCQ") and "Deliverability." The Contract defines "DCQ" as "the quantity of gas per day, averaged over each contract year, which Buyer is required to take from Seller hereunder at the point of delivery specified in this Agreement." (Contract, art. I[e].)

Since the Contract states that the DCQ is 90% of *Deliverability*, the extent of any take-or-pay obligation must be measured in accordance with the specific Contract definition of "Deliverability":

> [T]hat quantity of gas which Seller *has available for delivery* from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but *not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction*. Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects to take hereunder up to the maximum quantity which in accordance with good engineering and gas production practice can be produced from Seller's wells in the field.

(Contract, art. I[j]) (emphasis supplied.)[1]

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1. Although in its Jurisdictional Statement Lively references Contract language specifying how purely physical deliverability is to be tested and terms it the "specific use" of the term "deliverability" (Jurisdictional Statement, pp. 7-8), throughout trial the definition in art. I(j) was accepted as the proper definition of Deliverability by *both sides*. Lively submitted only the definition of Deliverability in art. I(j) as an instruction in its proposed charge.

Most of the Contract provisions cited herein are also set forth in the court of appeals opinion. (Lively's Appendix to Jurisdictional Statement, pp. 18-20).

Thus, the Contract's take-or-pay provision requires Valero to take, or pay for *if available*, 90% of the quantity of gas Lively has *available for delivery, not to exceed the maximum production allowed by the Railroad Commission of Texas* ("Commission").[2]

The take-or-pay provision was included to reassure Lively that Valero would not discriminate against Lively by taking gas from a producer with a lower price to the exclusion of Lively, whose gas in the subject area was dedicated to the Contract.

The Contract also includes what Lively calls a "governmental regulation" clause, expressly making the Contract *subject to* Texas laws and the rules and regulations of an "authority having jurisdiction" such as the Commission:

> This Agreement is made *subject to* all valid applicable federal and state laws or city ordinances, and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction.

(Contract, art. XIII, § 13.1.)

Additionally, the parties included a *force majeure* clause, specifying "temporary failure of wells or sources of supply of gas, or market" as events of *force majeure*. (Contract, art. XII, §§ 12.1, 12.2).

C. Relevant Laws and Regulations.

The Texas Natural Resources Code ("Code") accords the Commission authority to regulate the drilling,

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2. Valero and Lively agree that they are at all times subject to the regulatory authority of the Commission. Tex. Rev. Civ. Stat. arts. 6050-53 (Vernon 1962 and Vernon Supp. 1987); Tex. Nat. Res. Code Ann. Sec. 81.051, 111.081 (Vernon 1978).

production, transportation, and use of natural gas in Texas. The Code: defines "waste" as *"the production of natural gas in excess of* transportation or market facilities or *reasonable market demand* for the type of gas produced," Code § 86.012; declares "waste" to be unlawful, Code § 86.011; and charges the Commission with adopting "all necessary rules" to prevent it. *See generally* Code §§ 85.051, 85.052, 86.001, *et seq.*, 111.081, *et seq.* (Vernon 1978 and Vernon Supp. 1987).

The Commission also implements the Code's goal of "compelling *ratable* production," Code § 86.001, and carries out the Texas Common Purchaser Act's stipulation that a pipeline such as Valero must purchase gas without discrimination in favor of certain producers in a field and without unjust or unreasonable discrimination between fields in Texas. Code § 111.083 and § 111.086.

To discharge its Code-prescribed duties of conserving Texas' natural gas in an equitable manner, in 1978 the Commission adopted a system to "prorate" natural gas production — i.e., to determine the overall quantity of natural gas that should be produced in Texas in a given month and to assure that each producer is allowed to produce his fair share of that amount. The heart of this system is known as the Gas Market Demand Rule. 16 Tex. Admin. Code (§ 3.91) "§ 3.91" (prior to 9/1/86) and 16 Tex. Admin. Code § 3.30 ("§ 3.30") and § 3.34 ("§ 3.34") (from and after 9/1/86, as amended effective 3/2/87) ("Gas Market Demand Rule" or "Rule") (Lively's Appendix to Jurisdictional Statement ["Lively's Appendix"], pp. 286-303).

Valero and Lively agree on what the Rule requires. First, it requires an intrastate pipeline company such as

Valero: (i) to limit its purchases of gas from producers to proportionate shares of the pipeline's downstream market demand; (ii) to allocate its purchases "ratably" (without discrimination) among its various producers; and (iii) to purchase various categories of gas, established by the Commission, in a specified order of priority. (Lively's Appendix, pp. 288-92, 296-303).

Second, it proscribes a producer such as Lively from *producing* gas in excess of its ratable share of its purchaser's downstream market demand. (Lively's Appendix, pp. 286-87).

To ensure that production and takes are in accordance with market demand, the Rule explicitly sets forth steps that producers and pipelines must follow each month. Based on these specified procedures a pipeline then purchases gas from its sellers without discrimination and in accordance with the priority categories established by the Commission.

The overriding goal of Texas' regulatory scheme is to ensure that natural gas production does not exceed market demand and result in statutorily defined "waste," and that the market demand is fairly apportioned among producers.

D. The Interface Between the Gas Market Demand Rule and the Contract.

Pursuant to the *parties' own agreement* as reflected throughout the Contract, the take-or-pay provision and Gas Market Demand Rule work in tandem to define Valero's take-or-pay obligations. Both Valero's obligation to take and its alternative obligation to pay are limited *by the Contract's own terms* to the quantity Lively has

"available for delivery," "not exceeding the maximum rate of flow permitted by [Commission rules and regulations]." (Contract, art. V, § 5.3; art. I[j]). The Rule therefore governs the amount of gas Lively can have "available for delivery" at a given time, and establishes that the "maximum . . . rate of flow" under the Contract can never exceed Lively's ratable share of Valero's downstream market demand.[3]

It was undisputed at trial (and Lively has not argued otherwise in its Jurisdictional Statement or pleadings before the courts below) that *during the Contract years in issue Valero nominated, requested, took, and paid for Lively's ratable share of all gas for which Valero had a downstream market demand.*[4]

Any quantity exceeding the amount Valero actually took from Lively, therefore, could not be produced pursuant to Commission rules. The Contract *by its own terms* did not require Valero either to take or to pay for that amount of gas.

E. Lively's Lawsuit and Appeal.

Lively sued Valero for purportedly breaching the take-or-pay clause for the Contract years 1982-1985.

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3. It is worth noting that the Gas Market Demand Rule also established procedures preventing the discrimination the take-or-pay clause was originally included to discourage.

4. The undisputed testimony at trial showed that a natural gas "market" is a function of price. The Commission requires Valero to charge an inflexible price for its gas equal to the weighted average of gas ("WACOG") plus $0.15. Over the past few years Valero's WACOG plus $0.15 has equalled $4.00 to $4.20 per MMBtu of natural gas. Therefore, Valero's sales market is the market for $4.00 gas. Prices for natural gas have fallen, and the evidence showed that that market, during the contract years in issue, was very small.

The trial court submitted the take-or-pay claims to the jury in Special Issue No. 2, which asked: "Do you find that Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity ("DCQ")?" (Lively's Appendix, p. 9). Special Issue No. 2 was accompanied by instructions setting forth the relevant Contract provisions and regulations. (*Id.*, pp. 10-12). The jury answered Special Issue No. 2 "no," and the trial court entered a take-nothing judgment against Lively on its take-or-pay claim. (Lively's Appendix, p. 2).

After unsuccessful appeals to the Texas appellate courts, Lively now attempts to invoke this Court's jurisdiction by presenting two questions upon which it predicated *no objection* in the trial court and which were not asserted in points of error until its *motion for rehearing* before the court of appeals:

1. Whether the Railroad Commission of Texas Gas Market Demand Rule as applied by a Texas Court of Appeals voiding take-or-pay obligations and liability in a natural gas purchase contract is preempted by the Natural Gas Policy Act.

2. Whether the Railroad Commission of Texas Gas Market Demand Rule as applied by a Texas Court of Appeals voiding take-or-pay obligations and liability in a natural gas purchase contract violates the Commerce Clause of the United States Constitution.

(Jurisdictional Statement, p. I).

Not only were these questions tardily raised, Lively's argument concerning them embodies a complete mischaracterization of Valero's position and the court of

appeals opinion. Lively has erroneously asserted that Valero relies on the Gas Market Demand Rule as *unilaterally abrogating* or "voiding" otherwise existing contractual obligations:

> Valero seeks to avoid its obligations under [the take-or-pay] provision by asserting that the Railroad Commission Gas Market Demand Rule *abrogates* the take-or-pay provision . . .

(Lively's Appendix, p. 85) (emphasis supplied.)

However, as Valero has consistently maintained, whether the Rule unilaterally *abrogates* the take-or-pay provision is *not the issue* in this case. Rather, the issue is simply the interpretation of *this* Contract, in which the *quantity* of gas Valero is required to take *or pay for* is *defined* as an amount "available for delivery," "not exceeding the maximum . . . rate of flow permitted by [Commission] rules." (Contract, art. I[j].) The Contract does not require Valero's *payment* for a minimum quantity of gas as measured in Mcfs or Btus; it requires payment for a certain percentage of "Deliverability," a defined term that embodies any limitations on production by Commission rules and regulations.

Lively's entire argument is therefore based on a faulty premise, and ignores the plain words of this Contract. In essence, through this appeal Lively seeks to *rewrite* the Contract to delete its provisions that Valero's payment obligations are limited to payment for gas that can be legally produced. The logical extension of Lively's position, moreover, is that no party can ever contract, in a take-or-pay provision, to limit its payment obligation to payment for gas that can be legally delivered.

Lively also mischaracterizes the court of appeals' holding:

> [T]he effect of the Texas Court of Appeals' reliance upon the governmental regulation clause is to hold that the Texas Gas Market Demand Rule relieves *all* pipeline purchasers in Texas of their take-or-pay obligations under *all* of their natural gas contracts in the absence of an express provision to the contrary.

(Jurisdictional Statement, p. 12) (emphasis supplied).

It bears noting that the court of appeals did not predicate its analysis simply on the "governmental regulation clause" (Contract, art. XIII, § 13.1; *see* page 9, supra). Rather, it cited other relevant provisions of the Contract as well, including and emphasizing the definition of Deliverability. (Lively's Appendix, pp. 3-4). Of even more significance, however, the court of appeals nowhere held that all pipeline purchasers are relieved of all their take-or-pay obligations. Rather, it held that under the terms of the Contract, and in light of the undisputed evidence that Valero nominated and requested all of Lively's gas for which it had a downstream market demand, Valero had no liability to Lively. The plain words of the Contract compel dismissal of this appeal.

IV. Lively Failed to Timely Raise the Points of Error Upon Which it Appeals to This Court.

This Court should dismiss this appeal because "the federal question sought to be reviewed was not timely or properly raised and was not expressly passed on. . . ." Sup. Ct. R. 16(b), 28 U.S.C.A. 30-31 (1984).

The issues Lively raises in this appeal were not expressly passed on by the courts below. Moreover, Lively acknowledges it did not raise these points of error until its motion for rehearing to the court of appeals (Jurisdictional Statement, p. 4), which was untimely as a matter of law. Valero complained of this untimeliness in its Response in Opposition to Appellant's Motion for Rehearing in the court of appeals (Valero's Appendix, pp. 94-95) and Reply to Application for Writ of Error (Valero's Appendix, pp. 143-44).

Tex. R. App. P. 52(a) states:

> In order to preserve a complaint for appellate review, a party must have presented to the trial court a timely request, objection or motion, stating the specific grounds for the ruling he desired the court to make if the specific grounds were not apparent from the context.

Additionally, a party must assign a point of error concerning the matter complained of in its *initial* brief to the court of appeals; a motion for rehearing is too late. *Watson v. Glens Falls Ins. Co.*, 505 S.W.2d 793, 797-98 (Tex. 1974); *Lone Star Gas Co. v. Sheaner*, 305 S.W.2d 150, 153 (Tex. 1957); *Gillen v. Diadrill, Inc.*, 624 S.W.2d 259, 264 (Tex. App.—Corpus Christi 1981, writ dism'd); *see* Tex. R. Civ. P. 74(d).

Lively claims its points of error were raised at the first opportunity because, it contends, the court of appeals opinion *created* the federal question.

This assertion is incorrect. Lively's contention that a federal question exists is predicated on its mistaken notion that the court of appeals applied the Gas Market

Demand Rule to unilaterally void Valero's take-or-pay obligations under the Contract, with such an application allegedly resulting in preemption.

This purported application was the same complaint upon which Lively based many of its other arguments before the court of appeals in its initial briefing. For example, Lively's points of error 1 and 2 before the court of appeals contended the trial court erred "in admitting evidence of the . . . Rule" and "in including the . . . Rule [as an] Instruction . . . to Special Issue 2," both errors arising "because, as a matter of law, the Texas gas market demand rule does not relieve Valero of its contractual obligation to pay for the Daily Contract Quantity of gas. . . ." (Valero's Appendix, pp. 3, 10). The court of appeals opinion similarly explained Lively's contention as that the Rule "did not relieve Valero of its contractual obligation." (Lively's Appendix, p. 5).

By arguing that the Rule did not in and of itself relieve Valero of its take and payment obligations "as a matter of law," Lively was essentially complaining that the Rule was applied at trial to unilaterally abrogate Valero's contract rights, the same "application" Lively contends would result in federal preemption and impinge on the Commerce Clause. Since the same fallacious reasoning underlying many of Lively's initial arguments before the court of appeals also underpins these points of error, they also could have been raised before the motion for rehearing.

In fact, purported "amici curiae" (who actually were interested parties litigating against Valero), in a brief submitted to the court of appeals before it ruled, raised these very issues: "An incorrect holding that the

Texas conservation and prorationing statutes and regulations interfere with take-or-pay obligations will result in preemption of those statutes and regulations by federal law." (Valero's Appendix, p. 148). Although the court of appeals denied the amici leave to file their brief, if the amici raised these arguments earlier, Lively could have.[5]

The cases Lively cited do not support its proposition. In *Herndon v. State of Ga.*, 295 U.S. 441 (1935), for example, this Court held that the federal question was *not* timely raised:

> The federal question was never properly presented to the state supreme court unless upon motion for rehearing; and that court then refused to consider it. The long-established general rule is that the attempt to raise a federal question after judgment, upon a petition for rehearing, comes too late, unless the court actually entertains the question and decides it.

Id. at 443. While noting an exception to the rule — "if the ruling of the state court could not have been anticipated" — the Court held that the exception was not present, because a similar ruling made in another case rendered the petitioner "bound to anticipate the probability of a similar ruling in his own case, and preserve his right to a review here by appropriate action, . . ." *Id.* at 445.

Here, Lively obviously could have anticipated what it contends was the ruling of the court of appeals — that

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5. Points of error are only properly preserved for appeal if asserted in *appellant's* brief. *See, e.g., Samples Exterminators v. Samples*, 640 S.W.2d 873, 875 (Tex. 1982); *Frio Investments, Inc. v. 4IMC/Rohde*, 705 S.W.2d 784, 787 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.); *Norton v. Martin*, 703 S.W.2d 267, 273 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.).

the Gas Market Demand Rule voided contract rights — because it predicated other points of error before the court of appeals on the same basic complaint, and "amici" made the preemption argument *prior* to the court of appeals' ruling.

The other cases cited involved new points of error raised after a court's truly unpredictable reversal or reinterpretation of previously valid law. *Great N. Ry. Co. v. Sunburst Oil & Refining Co.*, 287 U.S. 358 (1932) (lower court overruled previously valid law for future but not previous transactions, and appellant complained on rehearing of dual standard's unconstitutionality); *Brinkerhoff-Faris Trust & Savings Co. v. Hill*, 281 U.S. 673 (1930) (state supreme court overruled previously valid authority); *State of Mo. v. Gehner*, 281 U.S. 313 (1930) (state supreme court construed statute in a manner completely differently from the lower court and the administrative body from whom appeal was originally taken). In this case, the court of appeals did not overrule previously valid law, and to the extent Lively contends it did, Lively anticipated such a ruling in other arguments advanced prior to the court of appeals' ruling.

In *Clark v. Jeter*, 486 U.S. 456, 108 S. Ct. 1910 (1988), the petitioner argued that a Pennsylvania statute conflicted with a federal statute. In determining not to reach this preemption argument, this Court stated:

> Having reviewed the record, we find that Clark did not adequately present a federal pre-emption argument to the lower courts. It is our practice, when reviewing decisions by state courts, not to decide federal claims that were not "pressed or passed upon" below.

Id. at 1913. Lively did not timely press its preemption argument in the lower courts, and it is foreclosed.

Finally, Lively's failure to comply with Texas procedure by untimely asserting its points of error renders the court of appeals judgment sustainable on an adequate non-federal basis. *See* Sup. Ct. R. 16(b), 28 U.S.C.A. 30-31 (1984).

V. Lively Raises No Federal Question at All, Much Less a Substantial One.

Lively's Jurisdictional Statement raises no federal question. Lively does *not* claim that the Gas Market Demand Rule *per se*, as applied to intrastate pipelines, is preempted or impinges upon the Commerce Clause. Rather, Lively claims that the Rule suffers these infirmities only "as [it was] construed and applied by the court of appeals" in this case. (Jurisdictional Statement, p. 12). Indeed, Lively embraces the rulings of "other courts," reviewing different contracts, that it alleges "have recognized that contractual obligations to pay for gas not taken are not *superseded* by the Texas Gas Market Demand Rule." (Jurisdictional Statement, p. 18) (emphasis supplied).

As shown, however, Lively flatly misstates how the appellate court "construed and applied" the Rule. A plain reading of the court of appeals opinion discloses that it nowhere held Valero's or other pipelines' take-or-pay obligations were unilaterally *superseded* or "voided" by the Gas Market Demand Rule. Rather, the court of appeals found that Valero and Lively had *agreed* that the payment obligation was limited to legal deliverability. (Lively's Appendix, p. 4).

Recognizing that the take-or-pay clause itself and other Contract provisions it references entirely undermine its premise, Lively disingenuously implies in its Jurisdictional Statement that the court of appeals only relied on the "governmental regulation" clause. Lively contends, citing no authority whatsoever, that this provision is common in take-or-pay contracts, and that allowing it alone to implicate the Gas Market Demand Rule would render all take-or-pay provisions ineffective. Whether this unsubstantiated assertion is true or not, and without analyzing the effect of the "governmental regulation" clause standing alone, the court of appeals opinion in fact referenced and emphasized other relevant Contract provisions. (Lively's Appendix, p. 4). The take-or-pay provision itself, read in conjunction with the definitions of DCQ and Deliverability, limits Valero's take *and* payment obligations to an amount Lively could legally produce and Valero could legally take. Nowhere in its Jurisdictional Statement does Lively suggest *any* error would have resulted from the court of appeals' reliance on those provisions, tacitly conceding such reliance rendered the opinion proper. Therefore, even accepting *arguendo* Lively's assertions and analysis, state law contract interpretation controls, and no federal question is presented. At the very least, independent state law grounds (the other Contract provisions interpreted in accordance with state law) support the court of appeals' judgment.

Moreover, no federal question would be presented even were Lively's interpretation of the court of appeals opinion correct. The cases Lively cites, *Northern Natural Gas Co. v. State Corp. Comm'n of Kan.*, 372 U.S. 84 (1962), *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Bd. of Miss.*, 474 U.S. 409 (1986) ("*Transco*"),

and *ANR Pipeline Co. v. Corporation Comm'n of the State of Okla.*, 860 F.2d 1571 (10th Cir. 1989), *cert. denied*, ____U.S.____, 109 S. Ct. 1967, 104 L.Ed.2d 435 (1989), all involved the application of state regulations to *interstate* pipelines, and actually underscore the *absence* of a rationale for preemption here.

In *Transco*, for example, in holding a ratable take order preempted for interstate pipelines, this Court noted in part that Transco's compliance with Mississippi's law "disturbs the uniformity of the federal scheme, since interstate pipelines would be forced to comply with varied state regulations of their purchasing practices." 474 U.S. at 423. Similarly, this Court in *Northern Natural Gas Co.* struck down the state orders at issue because they affected the ability of the Federal Power Commission, in part, to "achieve the uniformity of regulation which was an objective of the Natural Gas Act." 372 U.S. at 91-92. As an *intrastate* pipeline Valero is not subjected to "varied" practices.

The second rationale for preemption advanced in *Transco* — that the ratable take order would increase the ultimate price to consumers by forcing a pipeline to take noncontract gas in favor of contract gas, incurring take-or-pay liability — does not support, and in fact undermines, Lively's position. *See Transco*, 474 U.S. at 423. Valero's price would not be affected by the Rule under the *Transco* rationale. Accepting solely *arguendo* Lively's assertion that the Rule "as construed and applied" by the court of appeals "voids" take-or-pay obligations, any resulting effect on interstate commerce, by the *Transco* analysis, could only be a beneficial one. As this Court in *Transco* implicitly recognized, such an avoidance could only *reduce* prices borne by consumers, since pipelines

that must pay for gas they cannot take, and that are allowed to increase their prices, pass through such take-or-pay payments to consumers.

Finally, the Gas Market Demand Rule is fundamentally a regulation of production, since it precludes a producer from producing in excess of its ratable share of a purchaser's downstream market demand. (Lively's Appendix, pp. 286-87). Production regulation is not preempted by federal law even as it affects interstate pipelines. *Northwest Central Pipeline Corp. v. State Corporation Comm'n of Kan.*, ___U.S.___, 109 S. Ct. 1262, 1274-75, L.Ed.2d 509 (1989).

The Rule similarly does not impinge upon the Commerce Clause. In *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), this Court noted that a statute or regulation should be upheld where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, unless the burden imposed on interstate commerce "is clearly excessive in relation to the putative local benefits." 397 U.S. at 142. Protecting correlative rights is a legitimate state interest. *Northwest Central Pipeline Corp.*, 109 S. Ct. at 1278. As shown, the Rule as Lively claims the court of appeals construed it can have no significant impact on interstate commerce, and clearly cannot impinge on the Commerce Clause under the *Pike* test.

Lively cites no authority suggesting that state regulatory schemes applying to intrastate pipelines are preempted or encroach upon the Commerce Clause. In fact, this Court has distinguished between intrastate and interstate pipelines when considering such questions. *See Exxon Corp. v. Eagerton*, 462 U.S. 176, 185-87 (1983).

Lively presents no federal question, and its appeal should be dismissed.

VI. The Judgment of the Court Below Should be Affirmed.

The judgment of the court of appeals is plainly correct and should be affirmed. The Contract limits Valero's take and payment obligations to the amount of gas that can be legally produced, which the Gas Market Demand Rule specifies to be Lively's ratable share of Valero's downstream market demand. It is undisputed that Valero took and paid for the amount of gas Lively could legally produce. Therefore, the court of appeals' judgment was correct and should be affirmed.

VII. Conclusion and Prayer

In conclusion, Valero respectfully prays: that Lively's appeal be dismissed; alternatively, that the judgment of the court of appeals be affirmed in all respects; and that Valero be awarded its costs in this appeal.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that three true and correct copies of this Motion to Dismiss Appeal, and, Alternatively, to Affirm Judgment have been served on appellant by depositing an envelope containing them in a United States post office or mailbox, with first class postage prepaid, on January 8, 1990, addressed to Jesse P. Luton, Jr., Scott, Douglass & Luton, 4300 NCNB Center, 700 Louisiana Street, Houston, Texas.

J. Clifford Gunter III

J. CLIFFORD GUNTER III

Supreme Court, U.S.
FILED
JAN 8 1990
JOSEPH F. SPANIOL, JR.
CLERK

NO. 89-935

(4)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants

vs.

VALERO TRANSMISSION COMPANY,
Appellee

FROM NO. 04-87-00380-CV
IN THE COURT OF APPEALS FOR THE
FOURTH SUPREME JUDICIAL DISTRICT OF TEXAS
AT SAN ANTONIO, BEXAR COUNTY, TEXAS

APPENDIX TO MOTION TO DISMISS APPEAL AND, ALTERNATIVELY, TO AFFIRM JUDGMENT

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APPEAL NO. 04-87-00380-CV

IN THE

Court of Appeals

FOR THE
FOURTH SUPREME JUDICIAL DISTRICT OF TEXAS
SAN ANTONIO, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants,

v.

VALERO TRANSMISSION COMPANY,
Appellee.

Appeal from the District Court of
Sutton County, Texas, 112th Judicial District

BRIEF FOR APPELLANTS

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COMPLETE LIST OF THE PARTIES

Pursuant to Rule 74(a) of the Texas Rules of Appellate Procedure, a complete list of the names of all parties follows:

Appellants: Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley, Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H. B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters and Theodore L. Wilkinson.

Appellee: Valero Transmission Company.

APPEAL NO. 04-87-00380-CV

IN THE

Court of Appeals

FOR THE

FOURTH SUPREME JUDICIAL DISTRICT OF TEXAS

SAN ANTONIO, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants,

v.

VALERO TRANSMISSION COMPANY,
Appellee.

Appeal from the District Court of
Sutton County, Texas, 112th Judicial District

BRIEF FOR APPELLANTS

To The Court Of Appeals:

Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley,

Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H. B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters and Theodore L. Wilkinson (collectively referred to as "Lively" or "Appellants") file this Brief for Appellants with the Court of Appeals.

PRELIMINARY STATEMENT

This is an appeal of part of a final judgment following a jury trial (Tr. 188). The judgment arose from a suit filed by Lively against Valero Transmission Company ("Valero") for breach of a gas purchase contract (Tr. 3, 35). Lively alleged that Valero breached its obligations under the contract by failing to take delivery of and pay for the Daily Contract Quantity of natural gas during certain contract years or pay for such Daily Contract Quantity of natural gas, whether taken or not (Tr. 37), and by instituting a unilateral rollback of the price paid for gas actually taken under the contract (Tr. 38). The judgment ordered that Lively take nothing on their claim for breach of the take-or-pay provision of the contract, awarded Lively $1,204,778.60 on the pricing claim, and awarded Lively $500,000.00 for attorneys' fees.

Appellants seek a reversal of that part of the Trial Court's judgment ordering that they take nothing on their claim for breach of the take-or-pay provision of the gas purchase contract and an affirmance of the remainder of the judgment.

POINTS OF ERROR

POINT OF ERROR ONE: The Trial Court erred in admitting evidence of the Railroad Commission's gas market demand rule offered by Valero in support of its contention that such rule relieved Valero of its take-or-pay obligations under the contract, because, as a matter of law, the Texas gas market demand rule does not relieve Valero of its contractual obligation to pay for the Daily Contract Quantity of gas (S.F. 1680-1681).

POINT OF ERROR TWO: The Trial Court erred in including the gas market demand rule in Instruction 2 to Special Issue 2, because, as a matter of law, the Texas gas market demand rule does not relieve Valero of its contractual obligation to pay for the Daily Contract Quantity of gas (S.F. 1680-1682; Tr. 145-146).

POINT OF ERROR THREE: The Trial Court erred in the definition of the term "deliverability" used in Instruction 2 to Special Issue 2 (S.F. 1675; Tr. 145).

POINT OF ERROR FOUR: The Trial Court erred in failing to define the term "deliverability" as it is used in the take-or-pay provision of the gas purchase contract (S.F. 1676-1682; Tr. 145).

POINT OF ERROR FIVE: The Trial Court's instructions to Special Issue 2 were prejudicial comments on the weight of the evidence (Tr. 145-146).

POINT OF ERROR SIX: The Trial Court erred in conditionally submitting Special Issue 3 (S.F. 1682; Tr. 147).

POINT OF ERROR SEVEN: The Trial Court erred in entering judgment for Valero on and failing to set aside the jury's finding on take-or-pay liability (Special Issue 2, Tr. 145), because, as a matter of law, there was no evidence to support the finding.

POINT OF ERROR EIGHT: The Trial Court erred in entering judgment on and failing to set aside the jury's finding on take-or-pay liability (Special Issue 2, Tr. 145), because the only evidence in support of that finding is legally incorrect and is factually insufficient to support the finding.

POINT OF ERROR NINE: The Trial Court erred in entering judgment on and failing to set aside the jury's finding on take-or-pay liability (Special Issue 2, Tr. 145), because the finding was against the great weight and preponderance of the credible evidence, which conclusively showed that Valero failed to take or pay for the Daily Contract Quantity of gas.

STATEMENT OF FACTS

On or about February 12, 1973, Lively Exploration Company, on behalf of itself and all other Appellants named herein, entered into a Gas Purchase Contract (the "Contract") with Lo-Vaca Gathering Company ("Lo-Vaca") for the sale of natural gas produced from certain properties of Appellants in Sutton County, Texas ("the Contract Area") (P. Ex. 1; S.F. 115). Appellee, Valero, is the successor in interest to Lo-Vaca under the Contract (S.F. 57-58, 111).

The Contract grants Valero the exclusive right for 20 years to purchase all gas from the Contract Area.

Valero has the continuing right and obligation to purchase, upon the terms and conditions and at the prices specified in the Contract, all gas owned or controlled by Appellants from the Contract Area during the term of the Contract.

The Contract provides that Valero will, for each Contract Year, either (1) take delivery of and pay for the Daily Contract Quantity of natural gas or (2) pay for the Daily Contract Quantity of natural gas, whether taken or not. The Daily Contract Quantity is defined as a quantity of gas equal to ninety percent (90%) of Lively's daily deliverability of gas averaged over the Contract Year. The quantity of gas to be purchased by Valero each Contract Year is determined by multiplying the Daily Contract Quantity by the number of days during the Contract Year during which Valero's performance was not excused by the Contract.

Article V, ¶ 5.3, of the Contract provides, *inter alia*, as follows:

> Subject to the other provisions hereof, Buyer agrees to purchase and pay for (*or*, if Buyer's performance hereunder is not excused by other provisions of this Agreement, *pay for, if available, whether taken or not*) during the days of each contract year of the term hereof a Daily Contract Quantity of gas from Sellers' Lands and Leases in the Contract Area equal to ninety percent (90%) of Sellers' daily Deliverability of gas hereunder. Upon request by Buyer or Seller, *Sellers' Deliverability shall be determined and established by Buyer by testing the actual ability of Sellers' wells to deliver into Buyer's facilities at the points of delivery;* provided, however, neither Seller nor Buyer shall request such Deliverability test more often than once in any ninety (90)

> day period. Such Deliverability tests shall be made after a stabilized rate of flow has been achieved against such pressure as is required to deliver into Buyer's facilities at the operating pressure at the points delivery at the time of the test. . . .[1]

This provision in the Contract is commonly known in the oil and gas industry as a "take or pay" clause. Take-or-pay provisions in various forms have been standard provisions in gas purchase contracts since the early 1950's.

The Contract also contains a definition of the term "deliverability" which differs from the manner in which that term is used in the take-or-pay provision quoted above. Article I (j) of the Contract defines the term "deliverability" as:

> [T]hat quantity of gas which Seller has available for delivery from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction. Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects to take hereunder up to the maximum quantity which in accordance with good engineering and gas production practice can be produced from Seller's wells in the fields.

1. Emphasis added throughout except where indicated otherwise.

Beginning with the 1982 Contract Year (June 1, 1982 - May 31, 1983), and continuing through the 1985 Contract Year, Valero failed to either take and pay or simply pay for the minimum quantity of gas as required by the Contract. Valero's failure is a breach of the Contract for which Lively is entitled to recover.

Pursuant to Article VIII, ¶ 8.2, of the Contract, Lively calculated the amount due from Valero under the take-or-pay provision to be $21,264,689.30 (P. Ex. 51; S.F. 398). Article VIII, ¶ 8.2, provides:

> If Buyer shall fail in any contract year of the term hereof to take the quantity of gas that Buyer is obligated to take hereunder, then Seller shall, within sixty (60) days after such contract year render a bill to Buyer based upon the weighted average price, including tax reimbursement, in effect hereunder during the contract year in which such deficiency occurred, computed on the volumes delivered during the year and at the price, including tax reimbursement, applicable to such volumes at the time of delivery thereof. If Buyer agrees with such statement, Buyer will make payment to Seller for the amount of such statement within sixty (60) days after receiving Seller's statement. In computing the amount due Seller for any deficiency in takes by Buyer occurring during any contract year, there shall be deducted from such deficiencies the following quantities:
>
> (a) The total of the quantities which Buyer requested, up to 111% of the Daily Contract Quantity, and which Seller failed to deliver for any reason on any day or days during such contract year; and,
>
> (b) The total of the quantities of gas which Buyer was unable to take or failed to take on any day

or days during such contract year by reason of force majeure; and,

(c) The total of the quantities of gas by which there was a deficiency in Seller's allowable for the wells covered hereby below the Daily Contract Quantity on any day or days during such year, excluding any portion of such deficiency which is caused by, or is a result of, Buyer's failure to nominate to the Texas Railroad Commission to purchase a quantity of gas equal to the Daily Contract Quantity; and

(d) The total of the quantities of gas which Buyer refuses to take on any day or days during such year by reason of Seller's failure to meet any of the quality specifications or pressure requirements provided hereunder.

On September 29, 1983, Lively filed Plaintiffs' Original Petition in the 112th Judicial District Court of Sutton County (Tr. 3). Valero answered with a general denial and alleged numerous affirmative defenses to its liability.

On or about September 5, 1985, the Honorable Lawrence Fuller, Judge of the 143rd Judicial District Court, was assigned to hear this case on the withdrawal of the sitting District Court Judge, the Honorable Brock Jones. On September 16, 1985, the Trial Court granted Lively's Motion for Partial Summary Judgment as to liability only against Valero (Tr. 8). On or about October 29, 1986, the Honorable Bob Parks, having succeeded to the position of Judge of the 143rd Judicial District Court upon the appointment of the Honorable Lawrence Fuller to the El Paso Court of Appeals, entered an order setting aside the Order for Partial Summary Judgment (Tr. 29). Trial on the merits commenced on April 13, 1987. The jury returned their answers to special issues on April 22,

1987. On May 4, 1987, the Trial Court entered the judgment complained of herein and on May 11, 1987 denied Lively's Motion for Partial New Trial. Lively has timely perfected its appeal to this Court.

The Trial Court submitted this case to the jury by way of five special issues. Special Issues 1 and 1A inquired whether Lively and Valero modified the Contract to include under its terms and conditions the gas produced from certain wells (Tr. 143, 144). The jury answered both special issues in the affirmative, and Lively makes no complaint to this Court as to those findings.

The Trial Court submitted Lively's take-or-pay claim by way of two special issues to the jury. Special Issue 2 inquired whether "Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)?" (Tr. 145). Special Issue 3, concerning the amount of money that Valero owed to Lively for its failure to take or pay under the contract, was conditionally submitted by the Trial Court (Tr. 147). Special Issues 4 and 4a concern Lively's claim for underpayment by Valero for gas that Valero actually took (Tr. 150, 151). Special Issue 5 inquired about the reasonable and necessary attorneys' fees incurred by Lively in prosecuting this action (Tr. 152). Lively makes no complaint to this Court concerning the findings of Special Issues 4, 4a, and 5, which have been incorporated in the judgment on appeal herein.

ARGUMENT AND AUTHORITIES

POINT OF ERROR ONE RESTATED: The Trial Court erred in admitting evidence of the Railroad Commission's gas market demand rule offered by Valero in support of its contention that such rule relieved Valero of its take-or-pay obligations under the contract, because, as a matter of law, the Texas gas market demand rule does not relieve Valero of its contractual obligation to pay for the Daily Contract Quantity of gas (S.F. 1680-1681).

POINT OF ERROR TWO RESTATED: The Trial Court erred in including the gas market demand rule in Instruction 2 to Special Issue 2, because, as a matter of law, the Texas gas market demand rule does not relieve Valero of its contractual obligation to pay for the Daily Contract Quantity of gas (S.F. 1680-1682; Tr. 145-146).

Points of Error One and Two will be argued together, since both points relate to the application of the Texas gas market demand rule as a defense to take-or-pay obligations under natural gas contracts.

Article V, ¶ 5.3, of the Contract contains the take-or-pay provision relied upon by Lively in this case. Valero seeks to avoid its obligations under that provision by asserting that the Railroad Commission gas market demand rule abrogates the take-or-pay provision by limiting Valero's obligation to take gas to its market demand and consequently relieves Valero of its obligation to pay for the Daily Contract Quantity of gas not taken. It is Appellants' position that as a matter of law the Railroad Commission

gas market demand rule does not affect the rights and obligations of the parties to this Contract by relieving Valero of its obligation to pay for this minimum quantity of gas provided by the Contract.

Take-or-pay provisions in various forms have been recognized as standard provisions in gas purchase agreements since the early 1950's. 4 H. WILLIAMS & C. MEYERS, OIL & GAS LAW § 724.5 (1983). Courts have consistently held that such provisions are common in the industry and are not unconscionable or unfair. *Universal Resources Corp. v. Panhandle Eastern Pipeline Co.*, 813 F.2d 77 (5th Cir. 1987). The purpose of such clauses is to apportion the risks of natural gas production and sales between the buyer and seller. "The seller bears the risk of production. To compensate seller for that risk, buyer agrees to take, *or pay if not taken*, a minimum quantity of gas." *Universal Resources*, 813 F.2d at 80.

The Texas Railroad Commission's gas market demand rule clearly does not relieve Valero of its alternative obligation to pay for the Daily Contract Quantity of gas as required by the take-or-pay provisions of the Contract. The gas market demand rule and the associated ratable-take requirements relate to the *production* and *taking* of gas to prevent waste and protect correlative rights. They do not regulate the payment for gas not taken under take-or-pay provisions or natural gas contracts. No Texas statute or Railroad Commission regulation, either expressly or by implication, prohibits or excuses a purchaser from *paying for* the quantity of gas that purchaser has contractually obligated itself to pay. The Railroad Commission and the courts have recognized that contractual obligations to pay for gas not taken are not superseded by the gas market demand rule.

An attempt by the Railroad Commission to declare by regulation that the gas market demand rule relieved purchasers of contractual take-or-pay obligations was held invalid almost immediately after its adoption. On February 22, 1977, the Railroad Commission issued an interpretive order relating to the gas market demand rule, in which the Commission attempted to declare that take-or-pay provisions were invalid to the extent they contravened the provisions of that order. What has become known as the "penultimate paragraph" read as follows:

> IT IS FURTHER ORDERED that the provisions of any and all purchase or other agreements between producers and gas purchasers which contravene or are inconsistent with the provisions of this Order and [sic] are rendered inoperative, including, without limitation, provisions relative to (1) gas purchasers nominating to take gas in certain amounts or at certain levels, (2) producers asserting penalties, damages or other remedies against gas purchasers in the event of reductions in or cancellation of allowables and (3) *obligations requiring gas purchasers to take, or pay for it not taken, quantities greater than allowables set by this Commission.*

Railroad Commission Gas Well Allowable Order, 2 Tex. Reg. 785, 788 (1977).

Three lawsuits were filed in the Travis County district courts challenging the validity of that order. In one of those cases, *Dallas Production Co. v. Railroad Commission*, No. 260,641 (Dist. Ct. of Travis County, 53rd Judicial Dist. of Texas, June 10, 1977), the plaintiff asserted that the above-quoted paragraph was invalid because the Railroad Commission had exceeded its statutory authority by attempting to regulate take-or-pay con-

tracts.[2] The Court held that the order was unlawful, invalid, and of no force and effect, stating:

> The Court further finds that the above quoted penultimate paragraph herein declared invalid does not affect the rights, duties or obligations of Brazos Electric Power Cooperative, Inc. and Brazos Fuel Company, Inc., Intervenors, and Plaintiff producers under the take or pay provisions of their gas purchase agreements.

The Railroad Comission did not appeal this judgment and subsequently repromulgated the order without the invalid paragraph, and it became regularly adopted as the gas market demand rule. 3 Tex. Reg. 324 (1978). That rule with minor revisions was in effect during the 1982-1986 period covered by this litigation.

From the history surrounding its adoption, it is plain that the Texas gas market demand rule does not and cannot have the effect of overriding take-or-pay provisions in gas purchase agreements between producers and pipelines and does not provide a defense for the breach of those contractual obligations. This is clear from the district court's holding invalid that portion of the interpretive order which stated that the rule superseded private contractual provisions and the Railroad Commission's subsequent omission of the offending language in the replacement interpretive order.

In adopting the current gas market demand rule, rules 30 and 34 (sections 3.30 and 3.34), the Railroad Commission again stated that such regulations were not intended to modify existing private contractual relation-

2. Appendix at A1-A2.

ships. In the preamble, the Railroad Commission carefully describes the scope of those rules:

> Sections 3.30 and 3.34 are not intended to be a comprehensive statement of rights or obligations under the Common Purchaser Act, nor are they intended to preclude any complaints which may arise under the Act. *These amendments shall not affect existing contractual rights and obligations between parties.* 12 Tex. Reg. 536 (1987).

Courts have also rejected a gas market demand rule defense in the nature of that raised herein by Valero. In *Phillips v. Delhi Gas Pipeline Corp.*, No. 83-141 (Dist. Ct. of Houston County, 3rd Judicial Dist. of Texas, Oct. 21, 1986),[3] a partial summary judgment with respect to liability was rendered in favor of the plaintiffs on their take-or-pay claim. The defendants raised the gas market demand rule as a defense to the plaintiffs' claim. The court, in granting partial summary judgment, stated that "Defendants are liable for failing to take delivery from or pay Plaintiffs for the Daily Contract Volume of natural gas during each of the Annual Periods" and that the market demand rule and other defenses asserted by the pipelines "are not legally sufficient defenses to Plaintiffs' claims." *See also El Paso Natural Gas Co. v. G.H.R. Energy Corp.*, No. 85-09329 (Dist. Ct. of Harris County, 127th Judicial Dist. of Texas, Oct. 10, 1986),[4] where the court in granting the producers' motion for partial summary judgment, held that, "as a matter of law, the take-or-pay provision . . . is enforceable and performance

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3. Appendix at A3.

4. Appendix at A4.

is not excused on any basis, . . . including regulation by federal or state governmental authority. . . ."

Valero contends that the gas market demand rule modifies Valero's contractual take-or-pay obligation. Under Valero's theory, the gas market demand rule requires Valero to limit its purchases of gas from any producer to that producer's proportionate share of the downstream market demand. In essence, Valero argues that deliverability under the Contract is determined by Valero's market demand. Under Valero's contention, Valero's takes will always equal deliverability, and there can never be a deficiency under the take-or-pay provision of the Contract requiring Valero to pay for gas not taken.

Valero's contention fails to recognize the purpose and effect of the alternative performance obligations under the take-or-pay provision of the Contract. The courts have recognized that the take-or-pay clause is an alternative performance provision. *International Minerals & Chemical Corp. v. Llano, Inc.*, 770 F.2d 879 (10th Cir. 1985); *Superior Oil Co. v. Transco Energy Co.*, No. 84-2138-"L" (W.D. La. 1985).[5] Valero can perform by either (1) taking and paying for the specified minimum quantity of gas for the Contract Year or (2) paying for that minimum quantity of gas even though not taken during the Contract Year.

In *International Minerals*, the defendant International Minerals ("IMC") was the operator of a potash mine and processing facility in New Mexico. In 1972, IMC entered into a contract with plaintiff to purchase gas

5. Appendix at A5.

needed to run some of its equipment. In 1978, the New Mexico Environmental Improvement Board enacted Regulation 508, which limited emissions from potash processing equipment. In employing new technology necessary to comply with the regulation, IMC did not take or pay for the minimum quantity of gas as required under the contract. IMC alleged that the enactment of Regulation 508 was an event of force majeure and relieved it of any performance obligations under the gas purchase contract. The court rejected that position, stating:

> [E]ven if we assume arguendo that Rule 508 prevented IMC from taking the gas, Rule 508 would still pose no obstacle to IMC's ability to pay. Since this is a "take-or-pay" contract the buyer can perform in either of two ways. It can either (1) take the minimum purchase obligation of natural gas (and pay) or (2) pay the minimum bill. It is settled law that when a promisor can perform a contract in either of two alternative ways, the impracticability of one alternative does not excuse the promisor if performance by means of the other alternative is still practicable. (Citations omitted) *Paragraph 15* [*the force majeure clause*] *does not compel a different result; it would at most excuse IMC from its duty to "take," not from its duty to "pay."*

770 F.2d at 885.

In *Kaiser-Francis Oil Co. v. Producer's Gas Co.*, No. 83-C-400-B (N.D. Okla. June 19, 1985),[6] and *Southport Exploration Inc. v. Producer's Gas Co.*, No. 83-C-550-B (N.D. Okla. June 6, 1984),[7] the courts addressed the

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6. Appendix at A36.

7. Appendix at A47.

argument that a pipeline company had no obligation to make take-or-pay payments because production of the gas not taken would have exceeded the market demand for the gas and thus would have constituted waste under the Oklahoma conservation statutes. The court in *Kaiser-Francis,* recognizing the alternative performance obligations of a take-or-pay provision, specifically held that take-or-pay provisions are enforceable under the state market demand rule and statutes intended to prevent waste since *"the take-or-pay provisions of the contract do not require production, but rather provide for payment in lieu of production."*[8] In rejecting the pipeline company's argument, the court stated that such an "interpretation would render the take-or-pay provisions of the contracts virtually useless."[9]

The definition of "waste" is virtually the same in the Texas and Oklahoma conservation statutes. Section 86.012 of the Texas Natural Resources Code defines the term waste to include "the production of gas in excess of transportation or market facilities or reasonable market demand for the type of gas produced." Section 86.3 of 52 Oklahoma Statutes Annotated provides "the term 'waste', as applied to gas, in addition to its ordinary meaning, shall include . . . waste incident to the production of natural gas in excess of transportation and marketing facilities or reasonable market demands."

Alternative performance obligations have consistently been upheld by Texas courts. *Moss & Raley v. Wren,* 102 Tex. 567, 120 S.W. 847 (1909); *Kirkland v. Gaston,* 544 S.W.2d 694 (Tex. Civ. App.—Dallas 1976, no writ);

8. Appendix at A46.

9. Appendix at A42.

Carter v. Smith, 184 S.W. 244 (Tex. Civ. App.—Dallas 1916, no writ). Where a contract provides for alternative performance obligations, the fact that one alternative is prevented does not relieve the party from performing the second alternative. *Yankton Sioux Tribe of Indians v. United States*, 272 U.S. 351 (1926); *Ashland Oil & Refining Co. v. Cities Service Gas Co.*, 462 F.2d 204 (10th Cir. 1972); S. WILLISTON, CONTRACTS § 1961 (1971 and 1984 Supp.).

No cases have been found which hold that the enforcement of the alternative *pay* obligation of a take-or-pay provision is excused by the Texas gas market demand rule absent some specific contract language so providing. Any decision to the contrary would be illogical. The enforcement of the alternative *pay* obligation neither requires the producer to *produce* more gas than allowed by law nor requires the purchaser to *take* more gas than the market demand or discriminate among its producers.

Commentators have reached this same conclusion. In a recent article discussing the argument that the Texas gas market demand rule insulates pipeline purchasers from take-or-pay liability, one writer critiqued the argument this way:

> The pipeline argument has two parts: (1) that the prorationing and ratable take rules serve as a cap on the ability to take; and (2) that where the state says "thou shall not take," the state is also saying "thou shall not pay."
>
> . . . .
>
> The second part of the pipeline argument against take-or-pay clauses appears to be a non sequitur. Unless a contract provision excuses payment for gas

> in excess of quantities which the state permits to be taken, why should a regulatory limit on the ability to take also be a limit on the duty to pay? The Railroad Commission has no direct authority to relieve anyone of their contractual bargains. And the legislature has not adopted any explicit statutory controls over take-or-pay clauses. It would seem, therefore, that the take-or-pay issue should be considered entirely one of contract.

A. Anderson, *The Texas Approach to Gas Proration and Ratable Take*, 57 COLO. L. REV. 199, 221 (1986).

If the gas market demand rule has the effect asserted by Valero, the take-or-pay provision of the Contract becomes meaningless. It is well recognized that parties to and an instrument generally intend that every clause has some effect and purpose. *Pinehurst v. Spooner Addition Water Co.*, 432 S.W.2d 515 (Tex. 1968). Thus, Texas case law makes it clear that a contract should be construed in a manner which gives effect to all of its provisions. *Coker v. Coker*, 650 S.W.2d 391 (Tex. 1983); *Universal C.I.T. Credit Corp. v. Daniel*, 150 Tex. 513, 243 S.W.2d 154 (1951); *Sun Oil Co. v. Burns*, 125 Tex. 549, 84 S.W.2d 442 (1935); *Williams v. J & C Royalty Co.*, 254 S.W.2d 178 (Tex. Civ. App.—San Antonio 1952, writ ref'd). Accordingly, courts should avoid the adoption of a construction which would render any provision meaningless. *Mattison, Inc. v. W. F. Larson, Inc.*, 529 S.W.2d 271 (Tex. Civ. App.—Amarillo 1975, writ ref'd n.r.e.). A court has no right to nullify any terms of an agreement. *Williams v. J & C Royalty Co., supra.*

This Court's recent opinion in *Kodiak 1981 Drilling Partnership v. Delhi Gas Pipeline Corp.*, Appeal No. 04-84-00499-CV (Tex. App.—San Antonio, May 13, 1987,

no writ) (not yet reported), is not applicable to this appeal. In *Kodiak*, this Court affirmed a judgment based upon a finding that the "gas market failure" there relied upon by the pipeline company "excused Delhi's performance under the gas purchase agreement by virtue of the 'force majeure' provision of such agreement." (Slip opinion at 5). However, in this case, the jury made no such finding. The "force majeure" provision of the Contract was set forth in Instruction 3(c) of Special Issue 3, which was conditionally submitted by the Trial Court and not answered by the jury because of its answer to Special Issue 2. Further, there is a significant difference between the force majeure clause involved in *Kodiak* and that involved in the Contract here. The force majeure clause there defined "force majeure" in pertinent part as meaning "partial or entire failure to gas supply or market." The force majeure clause in the Contract here defines "force majeure" in pertinent part as including "temporary failure of wells or sources of supply of gas, or markets." There was no evidence presented by Valero in the trial of this case that Valero's failure to take or pay for Lively's gas was the result of a "temporary failure of wells or sources of supply of gas, or markets." For the above reasons, *Kodiak* is not applicable here.

It is clear from the above that the take-or-pay provisions of the Contract are an essential condition of the Contract and are binding upon Valero. Valero is not relieved from compliance with those provisions by the Texas gas market demand rule, and to uphold Valero's reliance upon that rule would render this take-or-pay provision of the Contract meaningless and deprive Lively of the protection of that important provision.

POINT OF ERROR THREE RESTATED: The Trial Court erred in the definition of the term "deliverability" used in Instruction 2 to Special Issue 2 (S.F. 1675; Tr. 145).

POINT OF ERROR FOUR RESTATED: The Trial Court erred in failing to define the term "deliverability" as it is used in the take-or-pay provision of the gas purchase contract (S.F. 1676-1682; Tr. 145).

Points of Error Three and Four will be argued together, as they both relate to the Trial Court's definition of "deliverability." The Trial Court clearly erred in the instructions to Special Issue 2 by defining the term "deliverability" as set forth in Article I(j) instead of as set forth in Article V, ¶ 5.3, which is the take-or-pay provision of the Contract. Under the Contract, Valero's take-or-pay liability is determined by comparing actual purchases of gas to ninety percent (90%) of "deliverability." The Contract expressly sets forth how "deliverability" is to be determined for take-or-pay purposes in Article V, ¶ 5.3, wherein it is stated:

> Upon request by Buyer or Seller, *Seller's Deliverability shall be determined and established by Buyer by testing the actual ability of Seller's wells to deliver into Buyer's facilities at the points of delivery;* provided, however, neither Seller nor Buyer shall request such Deliverability test more often than once in any ninety (90) day period. Such Deliverability tests shall be made after a stabilized rate of flow has been achieved against such pressure as is required to deliver into Buyer's facilities at the operating pressure at the points of delivery at the time of the test.

The evidence at trial established that Lively tested the actual ability of its wells to deliver into Valero's facilities and that the results of the tests were found in Lively's Form G-10 filings with the Railroad Commission (S.F. 227-231). The Court admitted Lively's Form G-10's into evidence (P. Ex. 13; S.F. 243). Lively calculated its take-or-pay damages based on the actual ability of the wells to deliver (P. Exs. 42, 49-51; S.F. 370, 442), in conformity with the express language of the take-or-pay provision in Article V, ¶ 5.3, of the Contract.

The Trial Court, however, used the wrong definition of the term "deliverability" in its instructions. The Court did not instruct the jury that "deliverability" for take-or-pay purposes means the actual ability of the wells to deliver into Valero's facilities, but instead gave the following instruction in connection with Special Issue 2:

> Lively's daily 'Deliverability' is defined by the Contract to be that quantity of gas which Lively had available for delivery from the Lands and Leases to Valero during each day in conformity with the requirements of the Contract, at a constant rate of flow, when Lively's wells were not produced in excess of their maximum efficient rate of flow, but not in excess of the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction. (Tr. 145).

Lively properly objected to the Trial Court's submission to the jury of Special Issue 2 and its accompanying instructions (S.F. 1675), thereby preserving error.

The Trial Court's error in submitting the wrong definition of "deliverability" in its instructions to Special Issue 2

is shown by a comparison of the Contract's use of the term in the definitions section of the Contract (Art. I(j)) and in the take-or-pay clause (Art. V, ¶ 5.3):

Art. I(j)	*Art. V, ¶ 5.3*
(j) The term "Deliverability" means that quantity of gas which Seller has available for delivery from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.	Upon request by Buyer or Seller, *Seller's Deliverability shall be determined and established by Buyer by testing the actual ability of Seller's wells to deliver into Buyer's facilities at the points of delivery;* provided, however, neither Seller nor Buyer shall request such deliverability tests more often than once in any ninety (90) day period. Such deliverability tests shall be made after a stabilized rate of flow has been achieved against such pressure as is required to deliver into Buyer's facilities at the operating pressure at the points delivery at the time of the test. . . .

To be proper, an explanatory instruction or definition must be correct. *Sanders v. Davila,* 593 S.W.2d 127 (Tex. Civ. App.—Amarillo 1979, writ ref'd n.r.e.). An explanatory instruction is improper if it is a misstatement of the law as applicable to the facts. *Wakefield v. Bevly,* 704 S.W.2d 339 (Tex. App.—Corpus Christi 1985, no writ). An erroneous definition given by the court may amount

to prejudicial error requiring reversal. *Gage v. Langford,* 582 S.W.2d 203 (Tex. Civ. App.—Eastland 1979, writ ref'd n.r.e.). Furthermore, an instruction which shifts to the jury the determination of a legal issue that should have been determined by the Trial Court involves the submission to the jury of a question of law, which is improper and requires reversal. *Foerster v. Peoples,* 362 S.W.2d 918 (Tex. Civ. App.—Amarillo 1962, no writ); *Barton v. Davis,* 441 S.W.2d 299, 301 (Tex. Civ. App. —El Paso 1969, writ ref'd n.r.e.); *Emmond's Inc. v. Obermiller,* 526 S.W.2d 562, 566 (Tex. Civ. App.— Corpus Christi 1975, writ ref'd n.r.e.).

The definition submitted by the Trial Court required the jury to determine the legal issue of whether the gas market demand rule, a regulation by an administrative agency, modifies existing contractual relationships between private parties. As discussed in Appellants' first and second points of error, as a matter of law the gas market demand rule does not affect private contract rights. The Trial Court's erroneous definition of the term "deliverability" in the instructions to Special Issue 2 was reasonably calculated to cause and did cause the rendition of an improper judgment, and the Trial Court's judgment in that respect should be set aside.

POINT OF ERROR FIVE RESTATED: The Trial Court's instructions to Special Issue 2 were prejudicial comments on the weight of the evidence (Tr. 145-146).

The Trial Court's instructions given with respect to Special Issue 2 were prejudicial comments on the weight of the evidence. In Instruction 2, the Court stated, in part:

> The term market demand means that amount of gas needed for current consumption.
>
> You are instructed that the production, transportation, or use of gas in a manner, in an amount, or under conditions which constitute waste is unlawful and is prohibited.
>
> You are instructed that the term "waste" includes the production of gas in excess of transportation or market facilities or reasonable market demand for the type of gas produced.

These instructions by the Trial Court constituted an impermissible comment that tilted or nudged the jury in favor of Valero, in violation of the Supreme Court's holding in *Lemos v. Montez,* 680 S.W.2d 798, 801 (Tex. 1984). In *Lemos*, the Court held that even legally correct instructions are not proper when they direct the jury towards a particular answer to a special issue. 680 S.W. 2d at 801.

Here, even if the Trial Court's definition of the term "waste" is accurate, it was irrelevant. There was no need for the Court to instruct the jury on "waste." Valero had the option of fulfilling its obligations under the Contract by either taking and paying for the Daily Contract Quantity or by merely paying for that gas. The Contract neither obligates Lively to produce, nor Valero to purchase, gas wastefully. Instead, the Contract specifically provides for payment in lieu of production. *Kaiser-Francis, supra.* There are no conservation statutes prohibiting Valero from paying even when it cannot take gas.

The Trial Court further commented improperly on the weight of the evidence by its quote from Article V, ¶ 5.2, of the Contract in Instruction 2, which stated:

> You are instructed that the Contract provides that subject to its other provisions, Valero shall have the right to purchase such quantity of gas per day as Valero may from day to day elect to purchase up to the total quantity per day which the wells are capable of producing when produced at their respective maximum efficient rates of flow, in Lively's sole judgment reasonably exercised, or at their respective allowable rates of flow under applicable orders, rules, regulations or laws, whichever is the lesser rate of flow (Tr. 145).

This instruction was not necessary to enable the jury to answer Special Issue 2. It impermissibly diverted the jury's attention from the central issue in Special Issue 2 —Did Valero fail to take or pay for an amount of gas equal to the Daily Contract Quantity? Its effect was to imply to the jury that Valero controls the quantity of gas that it is required to take and pay for or pay for if not taken. This implication is clearly contrary to the express terms of the Contract.

Submission of unnecessary instructions may be so prejudicial as to require reversal. *Samsel v. Diaz,* 659 S.W. 2d 143 (Tex. App.—Corpus Christi 1983, no writ). An unnecessary instruction that constitutes a comment on the weight of the evidence or which diverts the jury's attention from a central issue is error. *Lemos v. Montez, supra; City of San Antonio v. Roper Corp.,* 686 S.W.2d 602 (Tex. 1985).

Here, the Trial Court's error was clearly prejudicial to Lively. The jury found that Valero did not fail to take the Daily Contract Quantity when the evidence clearly established that Valero failed to do so and that Lively was damaged by that failure in an amount in excess of

$20 million. The Trial Court's submission of these instructions was improper, constituted judicial comments on the weight of the evidence, was highly prejudicial to Lively, and caused the rendition of an improper judgment.

POINT OF ERROR SIX RESTATED: The Trial Court erred in conditionally submitting Special Issue 3 (S.F. 1682; Tr. 147).

The errors in the Trial Court's instructions with respect to Special Issue 2 were compounded by the Court's conditionally submitting Special Issue 3, which was the ultimate or controlling issue in this case. Special Issue 3 in pertinent part was as follows:

> "What sum of money, if any, if paid now in cash, do you find to be due and owing to Lively under the Contract?" (Tr. 147).

Rules 277 and 279 of the Texas Rules of Civil Procedure provide that each party is entitled to have submitted to the jury the controlling issues for each ground of recovery or defense raised by the written pleadings and evidence in the case. Texas courts have long recognized this right. *Blanton v. E. & L. Transport Co.*, 146 Tex. 377, 207 S.W.2d 368 (1948); *Montgomery v. Gay*, 212 S.W.2d 941 (Tex. Civ. App.—Fort Worth 1948, no writ). "[T]his right cannot be lost or defeated by jury findings on other issues, which, in effect, indirectly negative a favorable finding on an issue not submitted, but raised by the evidence." *Blanton*, 207 S.W.2d at 369.

The conditional submission of special issues is not authorized where fundamental rights of the parties may be adversely affected. Accordingly, when the effect of

conditionally submitting an issue is to deprive the plaintiff of the submission of an independent ground of recovery, conditioning the issue is erroneous, 3 R. McDONALD, TEXAS CIVIL PRACTICE IN DISTRICT AND COUNTY COURTS §§ 12.16.1 and 12.16.2(b) (rev. 1983). The only appropriate solution is to remand the matter for a new trial.

Under the rules relating to special issue practice, only controlling or ultimate issues should be submitted to the jury. TEX. R. CIV. P. 277 and 279; *Holmes v. J. C. Penney Co.*, 382 S.W.2d 472 (Tex. 1964); *Rocha v. Ahmad*, 676 S.W.2d 149 (Tex. App.—San Antonio 1984, writ dism'd). Evidentiary issues, those which are embraced within or tend only to establish the fact of the controlling issue, should not be submitted to the jury. *Lambert v. H. Molsen & Co., Inc.*, 551 S.W.2d 151 (Tex. Civ. App.—Waco 1977, writ ref'd n.r.e.). An evidentiary issue may be considered by the jury in deciding the controlling issue, but it is not a controlling issue itself and should not be submitted. *Sell v. C.B. Smith Volkswagen, Inc.*, 611 S.W.2d 897 (Tex. Civ. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.).

As was argued by Lively at the charge conference (S.F. 1682-1683), Special Issue 3 was tthe ultimate and controlling issue in the case. The Daily Contract Quantity inquired about in Special Issue 2 was simply one of the many evidentiary matters to be considered by the jury in deciding the controlling issue. The Trial Court's conditional submission of the controlling issue in the case, predicated on a response to an evidentiary issue which should not have been submitted, deprived Lively of its right to have the controlling issue with respect to one of

its grounds for recovery determined by the jury. In effect, Lively's entire take-or-pay cause of action was submitted conditionally.

The conditional submission of Special Issue 3 was extremely prejudicial to Lively, constituted harmful error, and led to the rendition of an improper judgment.

POINT OF ERROR SEVEN RESTATED: The Trial Court erred in entering judgment for Valero on and failing to set aside the jury's finding on take-or-pay liability (Special Issue 2, Tr. 145), because, as a matter of law, there was no evidence to support the finding.

POINT OF ERROR EIGHT RESTATED: The Trial Court erred in entering judgment on and failing to set aside the jury's finding on take-or-pay liability (Special Issue 2, Tr. 145), because the only evidence in support of that finding is legally incorrect and is factually insufficient to support the finding.

POINT OF ERROR NINE RESTATED: The Trial Court erred in entering judgment on and failing to set aside the jury's finding on take-or-pay liability (Special Issue 2, Tr. 145), because the finding was against the great weight and preponderance of the credible evidence, which conclusively showed that Valero failed to take or pay for the Daily Contract Quantity of gas.

Points of Error Seven through Nine will be argued together, since they involve the determination of the central issue in this case—Valero's take-or-pay liability.

Appellants attack the judgment from three standpoints: (1) there was no evidence to support the jury's finding on take-or-pay liability; (2) there was insufficient evidence to support the jury's finding on take-or-pay liability; and (3) the jury's finding on take-or-pay liability was against and contrary to the great weight and preponderance of the evidence. Each of these arguments will be covered below under descriptive subheadings.

Special Issue 2 asked the jury to find whether "Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)?" The jury answered "No." This finding is unsupported by the evidence. The Contract defines "Daily Contract Quantity" as that quantity of gas equal to ninety percent (90%) of Lively's daily deliverability. The Trial Court used this definition in its instruction to Special Issue 2. All of the evidence presented to the jury, with but one exception, showed that Valero failed to take or pay for the quantity of gas equal to the Daily Contract Quantity. Lively presented extensive testimony concerning Valero's failure to take or pay for the Daily Contract Quantity during the Contract Years 1982, 1983, 1984, and 1985 (P. Exs. 38-42, 49-51, 57-60; S.F. 367-401). Even Valero's own evidence, with one exception, proved that Valero failed to take or pay for a quantity of gas equal to the Daily Contract Quantity.

Valero presented Herbert E. Warner, a partner with the accounting firm of Peat Marwick & Main, as an expert witness (S.F. 1384). Mr. Warner presented a series of exhibits calculating Valero's take-or-pay deficiency. Mr. Warner presented seven different "scenarios" showing Valero's take-or-pay deficiency. Six of these seven sce-

narios proved that Valero had failed to take or pay for a quantity of gas equal to the Daily Contract Quantity (D. Exs. 79-90). Only one out of Valero's own seven scenarios showed that Valero had not failed to take or pay for a quantity of gas equal to the Daily Contract Quantity (D. Exs. 78 and 91). However, that one scenario is based solely on the assumption that the term "deliverability" is the equivalent of the amount of gas that Valero actually took from Lively pursuant to the gas market demand rule. As heretofore discussed under Points of Error One and Two, the gas market demand rule does not abrogate Valero's obligation to pay for a quantity of gas equal to the Daily Contract Quantity. Valero's evidence based on this erroneous assumption is equally incorrect and thus constitutes no evidence.

Therefore, the only legally sufficient evidence presented to the jury concerning Valero's failure to take or pay for a quantity of gas equal to the Daily Contract Quantity proves that Valero did fail to take or pay for that quantity of gas as required by the Contract during each of the Contract Years involved.

A. There was no evidence to support the jury's finding on take-or-pay liability.

A "no evidence" point of error must be sustained when the record discloses one of the following:

(1) a complete absence of evidence of a vital fact;

(2) the court is barred by rules of law or evidence from giving weight to the only evidence offered to prove a vital fact;

(3) the evidence offered to prove a vital fact is no more than a mere scintilla of evidence; or

(4) the evidence establishes conclusively the opposite of a vital fact.

Royal Indemnity Co. v. Little Joe's Catfish Inn, Inc., 636 S.W.2d 530, 531 (Tex. App.—San Antonio 1982, no writ); R. Calvert, *"No Evidence" and "Insufficient Evidence" Points of Error*, 38 TEX. L. REV. 361, 363-365 (1960). In determining a "no evidence" point, the court is to consider only the evidence and inferences which tend to support the finding of the jury and disregard all evidence and inferences to the contrary. *Larson v. Cook Consultants, Inc.*, 690 S.W.2d 567, 568 (Tex. 1985).

In the present case, the evidence presented by both parties conclusively established that Valero failed to take or pay for a quantity of gas equal to the Daily Contract Quantity during each of the Contract Years involved. The evidence to the contrary is based entirely on Valero's invalid argument that the gas market demand rule abrogates its obligations under the Contract. Therefore, this Court is barred from considering the only evidence in the record which supports the jury's finding with respect to Special Issue 2.

When the jury finds the nonexistence of a vital fact or gives a negative answer to an issue inquiring as to the existence of a vital fact, its finding or answer need not be supported by evidence, and error can occur only if the facts have been conclusively established or established as a matter of law. *Jordan v. Ortho Pharmaceuticals, Inc.*, 696 S.W.2d 228, 235 (Tex. App.—San Antonio 1985,

no writ); *Pouncy v. Garner*, 626 S.W.2d 337 (Tex. App. —Tyler 1981, writ ref'd n.r.e.). When reviewing "matter of law" points, the Court should consider all of the evidence, and if the converse of the jury's findings is established conclusively, the point will be sustained. R. Calvert, *supra* p. 32, at 363-364; *Jordan*, 696 S.W.2d at 235.

Here, Lively conclusively established that Valero failed to take or pay for a quantity of gas equal to the Daily Contract Quantity in each of the Contract Years involved. The only evidence in the record to support the finding that Valero did not fail to take or pay for the minimum amount was presented in Defendant's Exhibits 78 and 91. Those exhibits are based entirely upon Valero's contention that the gas market demand rule abrogates Valero's obligations under the Contract (S.F. 1449). As heretofore shown, Valero's contention is incorrect as a matter of law.

B. There was insufficient evidence to support the jury's finding on take-or-pay liability, and the jury's finding was against the great weight and preponderance of the evidence.

When considering an "insufficient evidence" point of error, the court should consider and weigh all of the evidence in the case, including that in support of and that contrary to the challenged finding, to determine if the finding is so contrary to the great weight and preponderance of the evidence as to be clearly wrong and unjust. *Dyson v. Olin Corp.*, 692 S.W.2d 456, 457 (Tex. 1985); *Garza v. Alviar*, 395 S.W.2d 821, 823 (Tex. 1965). The court must let the jury, as the trier of fact, judge the credibility of the witnesses, assign the weight

to be given to their testimony, and resolve any conflicts in the testimony. However, here the only evidence in support of the jury's finding as to Special Issue 2 was wrong as a matter of law. As discussed in Points of Error One and Two, the gas market demand rule did not abrogate Valero's obligations under the Contract. Valero's sole evidence in favor of the jury's finding has no probative value. The jury's finding is against the great weight and preponderance of the evidence, presented by both Lively and Valero, that Valero failed to take or pay for the minimum quantity of gas for each of the Contract Years involved. The challenged finding is against the great weight and preponderance of the evidence so as to be clearly wrong and unjust, and this Court should set the finding aside and order a new trial as to that part.

The jury's finding with respect to Special Issue 2 is supported by no evidence, by insufficient evidence, is contrary to the great weight and preponderance of the evidence, is clearly wrong and unjust, and is incorrect as a matter of law. For these reasons, Appellants respectfully submit that this Court should reverse the judgment of the Trial Court and render judgment that Valero is liable to Lively for Valero's failure to pay for the Daily Contract Quantity under the Contract for the Contract Years 1982, 1983, 1984, and 1985 and remand this case to the Trial Court for a determination of the amounts owed to Lively by Valero as a result of such failure.

CONCLUSION

The Trial Court clearly erred in the respects set forth in the above Points of Error, and those errors did cause rendition of an improper judgment in the case in part, which is clearly separable without unfairness to the parties.

Therefore, it is respectfully submitted that under Rule 81 of the Texas Rules of Appellate Procedure that the judgment should be reversed as to the part complained of by Appellants, judgment rendered in favor of Lively with respect to liability, and a new trial ordered to determine the amount of damages owed to Lively by Valero.

PRAYER FOR RELIEF

Appellants respectfully request that this Court reverse the judgment of the Trial Court that Lively take nothing by way of their take-or-pay cause of action, render judgment that Valero is liable to Lively for its failure to pay for the Daily Contract Quantity under the Contract for the Contract Years 1982, 1983, 1984, and 1985, remand the case for a new trial as to the amount owed to Lively by Valero, in all other respects affirm the Trial Court's judgment, and grant Appellants Lively such other and further relief to which they be justly entitled.

Respectfully submtited,

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CERTIFICATE OF SERVICE

I hereby certify that the above and foregoing Brief for Appellants, together with the Appendix thereto, was served on Appellee or its attorney by delivery of a true copy by certified mail, return receipt requested, by depositing it, postpaid, in an official depository under the care and custody of the United States Postal Service on the 26th day of August, 1987, enclosed in a wrapper addressed as follows:

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Jesse P. Luton, Jr.

JESSE P. LUTON, JR.

NO. 04-87-00380-CV

IN THE COURT OF APPEALS FOR THE
FOURTH SUPREME JUDICIAL DISTRICT
OF TEXAS AT
SAN ANTONIO, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants

v.

VALERO TRANSMISSION COMPANY,
Appellee

APPEALED FROM THE DISTRICT COURT
OF SUTTON COUNTY
112th DISTRICT COURT OF TEXAS

APPELLEE'S BRIEF

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APPELLEE REQUESTS ORAL ARGUMENT

COMPLETE LIST OF THE PARTIES

Pursuant to Rule 74(c) of the Texas Rules of Appellate Procedure, a complete list of the names of all parties follows:

Appellants:

Lively Exploration Company
Lea Roy Aldwell, Individually
Lea Roy Aldwell
Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased
Jon A. Sonnen
J. Howard Marshall
Ed Farrell
Elizabeth Standish
The Desana Corporation
Jessee L. Dally
Chester H. Kenley
Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased
H. B. Lively
B. Jackson Bandy
Robert L. Banks
Theo B. Bean
William R. Gifford
Charlie Gill, Jr.
Henry Gunders and wife, Elaine Gunders
Kenneth L. Hewitt
Kallman Nashner
Frank Pace, Jr.
Martin B. Seretean
Ray B. Vaughters
Theodore L. Wilkinson

Appellee:

Valero Transmission Company

I. NATURE OF THE CASE

Appellants Lively Exploration Company, et al. are appealing the trial court's take-nothing judgment against them on their claim against Valero for breach of a "take-or-pay" provision in a gas purchase contract.

II. REPLY POINTS OF ERROR

First Reply Point of Error:

THE TRIAL COURT DID NOT ERR IN ADMITTING EVIDENCE OF THE RAILROAD COMMISSION'S GAS MARKET DEMAND RULE OFFERED BY VALERO (Reply To Appellants' Point Of Error One).

Second Reply Point of Error:

THE TRIAL COURT DID NOT ERR IN INCLUDING THE GAS MARKET DEMAND RULE IN INSTRUCTION 2 TO SPECIAL ISSUE 2 (Reply To Appellants' Point Of Error Two).

Third Reply Point of Error:

THE TRIAL COURT DID NOT ERR IN DEFINING THE TERM DELIVERABILITY USED IN INSTRUCTION 2 TO SPECIAL ISSUE 2 (Reply To Appellants' Points of Error Three and Four).

Fourth Reply Point of Error:

THE TRIAL COURT'S INSTRUCTIONS TO SPECIAL ISSUE TWO WERE ENTIRELY PROPER AND WERE NOT PREJUDICIAL COMMENTS ON THE WEIGHT OF THE EVIDENCE (Reply to Appellants' Point of Error Five).

Fifth Reply Point of Error:

THE TRIAL COURT DID NOT ERR IN CONDITIONALLY SUBMITTING SPECIAL ISSUE THREE (Reply to Appellants' Point of Error Six).

Sixth Reply Point of Error:

THE TRIAL COURT PROPERLY ENTERED JUDGMENT FOR VALERO ON THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY, BECAUSE THERE WAS SOME EVIDENCE TO SUPPORT THE JURY'S FINDING (Reply to Appellants' Point of Error Seven).

Seventh Reply Point of Error:

THE TRIAL COURT PROPERLY ENTERED JUDGMENT ON THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY BECAUSE THE EVIDENCE IN SUPPORT OF THAT FINDING WAS LEGALLY CORRECT AND FACTUALLY SUFFICIENT TO SUPPORT THE FINDING (Reply to Appellants' Point of Error Eight).

Eighth Reply Point of Error:

THE TRIAL COURT PROPERLY ENTERED JUDGMENT ON THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY BECAUSE THE FINDING WAS AMPLY SUPPORTED BY THE EVIDENCE, AND WAS NOT AGAINST THE GREAT WEIGHT AND PREPONDERANCE OF THE CREDIBLE EVIDENCE (Reply to Appellants' Point of Error Nine).

III. STATEMENT OF FACTS

A. *The Parties.*

Valero Transmission Company ("Valero"), Appellee, is a public utility intrastate gas pipeline company that purchases, transports, and sells natural gas throughout the State of Texas. Valero operates over 7,000 miles of pipeline, connected to over 13,000 wells. (S.F. 542, 677.) Valero's customers include gas distribution companies that service cities such as San Antonio, Austin, and Dallas, industrial consumers, and other pipeline companies. (S.F. 529-30.) Valero meets its customers' forecasted demands by acquiring natural gas from over 800 producers pursuant to approximately 2400 gas purchase contracts. (S.F. 542.)

Lively Exploration Company and the other appellants (collectively "Lively") are producers, operators, royalty interest owners, and sellers of oil and gas in Texas. (S.F. 105-07). It is uncontroverted that both Valero and Lively are at all times subject to the regulatory authority of the Railroad Commission of Texas ("Commission"). Tex. Rev. Civ. Stat. arts. 6050-53 (Vernon 1962 and Vernon Supp. 1987); Tex. Nat. Res. Code Ann. Sec. 81.051, 111.081 (Vernon 1978). (S.F. 419-23; 675, 1552, 1556.)

B. *The Contract.*

On February 12, 1973, Lively entered into a Gas Purchase Agreement ("Contract") (P. Ex. 1) with Valero's predecessor-in-interest for the sale of natural gas produced from Lively's properties in Sutton County, Texas. It is undisputed that at the time Lively and Valero entered into the Contract, demand for natural gas far outstripped supply, and neither Lively nor Valero foresaw

that eventually the natural gas industry would suffer from a dramatic oversupply that would change the entire nature of the industry. (S.F. 147-48, 593-94.)

Lively and Valero included various provisions in the Contract relevant to this lawsuit. Among these provisions is a "take-or-pay" provision:

> *Subject to the other provisions hereof,* Buyer agrees to purchase and pay for (or, *if Buyer's performance hereunder is not excused by other provisions of this agreement,* pay for, *if available,* whether taken or not) during the days of each Contract year . . . a *Daily Contract Quantity* of gas from Seller's Lands and Leases in the Contract Area equal to ninety percent (90%) of Seller's daily *Deliverability* of gas hereunder.

(P. Ex. 1, p.12, Art V, § 5.3) (emphasis supplied).

The take-or-pay provision references two specific terms that are defined in the Contract and operate with the take-or-pay clause to set forth Valero's take-or-pay obligations: "Daily Contract Quantity" ("DCQ") and "Deliverability." The Contract defines "DCQ" as "the quantity of gas per day, averaged over each contract year, which Buyer is required to take from Seller hereunder at the point of delivery specified in this Agreement." (P. Ex. 1, p. 2, art. I[e].)

Since the Contract states that the DCQ is 90% of *Deliverability,* the extent of any take-or-pay obligation must be measured in accordance with the specific Contract definition of "Deliverability":

> [T]hat quantity of gas which Seller *has available for delivery* from the Lands and Leases to Buyer during each day, in conformity with the requirements of

> this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but *not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction*. Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects to take hereunder up to the maximum quantity in accordance with good engineering and gas production practice can be produced from Seller's wells in the field.

(P. Ex. 1, p. 3, art. I[j]) (emphasis supplied.)[1]

Thus, the take-or-pay provision in the Contract requires Valero to take, or pay for *if available*, 90% of the quantity of gas Lively has *available for delivery, not to exceed* the maximum production allowed by the Railroad Commission of Texas ("Commission").

The take-or-pay provision was included to reassure Lively that Valero would not discriminate against Lively by taking gas from a producer with a lower price to the exclusion of Lively, whose gas in the subject area was dedicated to the Contract.

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1. Although in its Brief for Appellants, Lively argues that the Contract also contains another definition of "Deliverability," throughout trial the definition in art. I(j) was accepted as the proper one by ***both sides***. Lively in fact submitted ***only the definition*** in art. I(j) of "Deliverability" as an instruction in its proposed charge (Tr. 66, 73.)

The Contract also includes a "regulatory bodies" clause expressly making the Contract *subject to* Texas laws and the rules and regulations of an "authority having jurisdiction" such as the Commission:

> This Agreement is made *subject to* all valid applicable federal and state laws or city ordinances, and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction.

(P. Ex. 1, p. 27, art. XIII, § 13.1.)

Additionally, the parties included a *force majeure* clause:

> If either party hereto is rendered unable, wholly or in part, by force majeure, or other causes herein specified, to carry out its obligations under this Agreement, other than any matured obligation to pay money, it is agreed that upon notice . . . then the obligations of the party giving such notice, so far as they are affected by such force majeure or other causes herein specified, shall be suspended during the continuance of any inability so caused. . . .
>
> * * *
>
> The term "force majeure" as employed herein includes without limitation by the following enumeration acts of God . . . *temporary failure of wells or sources of supply of gas, or market;* and any other causes, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming suspension and which by the exercise of due diligence such party is unable, wholly or in part, to prevent or overcome. . . .

(P. Ex. 1, pp. 26-26A, art. XII, §§ 12.1,12.2.)

C. *Relevant Laws and Regulations.*

1. *The Regulated Nature of the Texas Oil and Gas Industry.*

The repeated deference in Contract provisions to Texas laws and Commission rules and regulations reflects the parties' recognition that the Commission regulates basically all facets of the drilling, production, transportation, and use of natural gas in Texas. (S.F. 419-23, 1474.)

The Commission's authority is accorded by the Texas Natural Resources Code ("Code"). The Code declares "waste" to be unlawful, and defines "waste" as *"the production of natural gas in excess of* transportation or market facilities, or *reasonable market demand* for the type of gas produced." Tex. Nat. Res. Code Ann. § 86.001-.012 (Vernon 1978) (emphasis supplied) (S.F. 1491). The Code charges the Commission with adopting "all necessary rules" to ensure production of natural gas in accordance with market demand and to prevent its *waste*. Code §§ 85.051, 85.052, 86.001, *et seq.*, 111.081, *et seq.* (Vernon 1978 and Vernon Supp. 1987) (emphasis supplied.)

The Commission also implements the Code's goal of "compelling *ratable* production," Code § 86.001, and carries out the Texas Common Purchaser Act's stipulation that a pipeline such as Valero must purchase gas without discrimination in favor of one producer or person against another producer or person in the same field and without unjust or unreasonable discrimination between fields in Texas. Code § 111.083 and § 111.086.

2. *The Gas Market Demand Rule Adopted in 1978.*

To discharge its Code-prescribed duties of conserving Texas' precious natural gas in an equitable manner, in

1978 the Commission adopted a system to "prorate" natural gas production — i.e., to determine the overall quantity of natural gas that should be produced in Texas in a given month and to assure that each producer is allowed to produce his fair share of that amount. (S.F. 1551.) The heart of this system, and one of the primary regulations with which Valero and Lively are required to comply, is known as the Gas Market Demand Rule. 16 Tex. Admin. Code § 3.91 ("§ 3.91") (prior to 9/1/86) and 16 Tex. Admin. Code § 3.30 ("§ 3.30") and § 3.34 ("§ 3.34") (from and after 9/1/86, as amended effective 3/2/87) ("Gas Market Demand Rule" or "Rule"). (D. Ex. 7; S.F. 1491-94.)[2]

Both Valero and Lively *agree* on what the Gas Market Demand Rule says and requires. At trial, Valero presented uncontroverted testimony by John Poerner ("Poerner"), a Railroad Commissioner when the Gas Market Demand Rule was adopted and subsequently chairman of the Commission, who thoroughly explained the Rule and its operation. (S.F. 1472-1556.)

As Poerner elucidated, the Rule's gravamen is two-fold. First, it requires an intrastate pipeline company such as Valero: (i) *to limit its purchases* of gas from producers to proportionate shares of the pipeline's down-stream market demand; (ii) *to allocate its purchases* "ratably" (without discrimination) among its various producers; and (iii) to purchase various categories of

2. The Gas Market Demand Rule as issued on January 16, 1978 was introduced into evidence as D, Ex. 7. Lively objected to evidence of amendments after the Contract years at issue, and the trial court excluded such evidence. Thus, all citations to sections of the Gas Market Demand Rule are to the sections as in effect during the Contract years at issue, and as reflected in D. Ex. 7.

gas, established by the Commission, in a specified order of priority. 16 Tex. Admin. Code § 3.91 (prior to 9/1/86); (D. Ex. 7, 21; S.F. 324-25, 689, 693, 910, 989, 1007, 1050, 1494.)

Second, it proscribes a *producer* such as Lively from producing gas in excess of its ratable share of its purchaser's downstream market demand. (S.F. 935, 989, 1050, 1552, 1556.) The achievement of ratability *requires* participation by the producers, since producers, not pipelines, have physical control of the wells and the quantity of gas actually produced. (S.F. 715, 1344.)

To ensure that production and takes are in accordance with market demand, the Gas Market Demand Rule explicitly sets forth steps that producers and pipelines must follow each month. To summarize, early each month a pipeline's downstream customers give the pipeline "nominations" of their "firm forecast of . . . [their] actual demand." (D. Ex. 7, § .001(d)(2)(A); S.F. 683-84.) The pipeline then files its own nomination with the Commission reflecting the amount of gas it expects to take from each field. (S.F. 1318-19.) The pipeline must nominate an amount *equal to* the total quantity for which it is the ultimate consumer and the total quantity nominated by its downstream purchasers. (D. Ex. 7, § .001(d); S.F. 682-84.) In making its nominations, a pipeline must "ratably apportion" them from the fields from which it purchases and from the gas wells connected to its system. (D. Ex. 7, § .001(e).) A pipeline must also make its nominations according to the Commission's "priority system" of different categories of gas. *Id.* The priority system requires a pipeline to nominate, take, and exhaust all of a higher

category of gas available from its producers before taking any gas in a lower category. (*Id.*, D. Ex. 20; S.F. 693, 1324-25.)[3]

The pipeline then tells its producers the amount it intends to nominate, so that they can forecast production. (S.F. 685-86, 1321.) The Commission adds up nominations of all pipelines taking gas from a given field, divides that number among the wells in a field and allocates an amount of production to each particular well. (S.F. 1499-1500.) This amount is the well's "full prorated allowable." (S.F. 1336, 1500.)

Because actual market demand may deviate from the amount projected by a pipeline in its nomination, each month a pipeline gives each of its producers a "rate of flow request" letting it know the pipeline's actual market demand, and how much gas the producer should tender to supply its ratable share of that market demand. (S.F. 686-87.) If the pipeline's demand is less than projected in its nomination, production from each well *must* be reduced ratably (proportionately), even though the well's "allowable" may be set at a higher amount. (S.F. 687.) Based on the procedures outlined in the

3. Specifically, under the 1978 Gas Market Demand Rule "casinghead gas" was given the highest priority, followed by gas classified as "Rule 49(b)" gas as second priority, and "special allowable" gas as third priority. (S.F. 591, 622, 689, 1494.) Valero must purchase all *priority* gas ("casinghead," then "Rule 49(b)," and then "special allowable" gas) dedicated to its system before it can purchase *any non-priority* gas (such as the prorated "gas well gas" produced by Lively.) (S.F. 693.)

The Commission established the priority categories based on sound public policy considerations. For example, in according casinghead gas highest priority the Commission was mindful of the Arab oil embargo, since curtailment of casinghead gas interrupts oil production. (S.F. 1494.)

Gas Market Demand Rule a pipeline then purchases gas without discrimination and in accordance with the priority categories. (S.F. 934.)

In summary, the overriding goal of Texas' complex and carefully drawn regulatory scheme governing the oil and gas industry is to ensure that production of natural gas does not exceed market demand and result in "waste" as that term is defined by statute, and that production of the market demand is fairly apportioned among producers. (S.F. 1491-93, 1499, 1551.)

D. *The Interface Between the Gas Market Demand Rule and the Contract.*

Pursuant to the *parties' own agreement* as reflected throughout the Contract, the take-or-pay provision and Gas Market Demand Rule work in tandem to define Valero's take-or-pay obligations. Both Valero's obligation to take and its alternative obligation to pay are limited *by the Contract's own terms* to the quantity Lively has "available for delivery," "not exceeding the maximum rate of flow permitted by [Commission rules and regulations]." The Gas Market Demand Rule governs the amount of gas Lively can have "available for delivery" at a given time, and establishes that the "maximum . . . rate of flow" under the Contract can never exceed Valero's downstream market demand.[4]

It is *uncontroverted* that Valero's downstream market demand has drastically declined. (S.F. 568, 571, 1040, 1483-84, 1532; D. Ex. 11A, 38, 64.) It was similarly

4. It is worth noting that the Gas Market Demand Rule also established procedures preventing the discrimination the take-or-pay clause was originally included to discourage.

conclusively demonstrated at trial (and Appellants do not argue otherwise in their Brief) that during the Contract years in issue Valero nominated and requested *all* of Lively's gas for which Valero had a downstream market demand. (S.F. 1349-51, 1376.)

Any quantity exceeding the amount Valero actually took from Lively, therefore, could not be produced pursuant to Commission rules, and the Contract by its own terms did not require Valero either to take or to pay for that amount of gas.

E. *Lively's Lawsuit*

Despite the fact that Valero had clearly complied with the Contract's take-or-pay provisions, Lively sued Valero for purportedly breaching the take-or-pay clause for the Contract years 1982-1985. Valero therefore found itself in the ironic position of *defending* a breach of contract lawsuit despite its compliance with the plain terms of the Contract.

F. *The Trial.*

At trial, Lively called only three witnesses: Harry Lively, who testified about the Contract although he had not negotiated it (S.F. 149-50); Jimmy Condra, who testified as to the results of alleged "deliverability tests" on the wells even though he had not run the tests himself in the last five years (S.F. 660-61) and even though the pumper he claimed had run the tests testified that he had never run such tests (S.F. 952-53); and Max Powell, who testified as to alleged take-or-pay damages. (S.F. 367-403.)

Valero called a number of witnesses, including: John Poerner, who testified concerning the meaning and import of the Gas Market Demand Rule (S.F. 1447-1552); Frank J. Becraft, President of Valero, and Jeffrey H. Parish, Director of Proration and Producer Affairs of Valero, who testified as to the decline in Valero's downstream market and Valero's strict adherence to the Gas Market Demand Rule (S.F. 531-34, 565-73, 710, 713, 675-936, 1307-76); Travis B. Crow, Valero's Director of Reserve Evaluation, who testified about the unreliability of Lively's "deliverability" tests (S.F. 1191-1271); Dr. Alan Anderson, who testified about the decline in Valero's downstream markets; and several others.

The take-or-pay claims were submitted to the jury. In response to Special Issue No. 2, the jury answered "no" to the question, "Do you find that Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity ("DCQ")?" (Tr. 145.) Thus, on May 4, 1987, the Honorable Judge Bob Parks properly entered a take-nothing judgment against Lively on its take-or-pay claim against Valero. (Tr. 158).

G. *The Appeal*

Lively has appealed the judgment as to its take-or-pay claim. The trial court's judgment is supported by both the law and the evidence, and should be sustained.

In its Brief for Appellants ("Lively's Brief"), Lively recognizes that it cannot undermine the jury's verdict or the trial court's judgment based on the Record or the applicable law. Therefore, in its Brief Lively grossly distorts the plain meaning of some Contract provisions and omits reference to others, completely

mischaracterizes Valero's position, and wholly ignores the overwhelming evidence supporting the jury's findings, most of which Lively did not even attempt to controvert at trial. In desperation, Lively even complains on appeal of an instruction to the jury that *Lively* submitted.

That Lively cannot rely on the Record as it exists and the Contract as it is written exposes its recognition that an accurate characterization of the Contracts, the law, and the evidence compels affirmance of the trial court's judgment.

IV. THE RELEVANCE OF THE GAS MARKET DEMAND RULE

First Reply Point of Error (Restated):

THE TRIAL COURT DID NOT ERR IN ADMITTING EVIDENCE OF THE RAILROAD COMMISSION'S GAS MARKET DEMAND RULE OFFERED BY VALERO (Reply to Appellants' Point of Error One).

Second Reply Point of Error (Restated):

THE TRIAL COURT DID NOT ERR IN INCLUDING THE GAS MARKET DEMAND RULE IN INSTRUCTION 2 TO SPECIAL ISSUE 2 (Reply to Appellants' Point of Error Two).

A. *The Overall Fallacy in Lively's Argument.*

Lively's argument under its First and Second Points of Error embodies a gross mischaracterization of Valero's position at trial. Lively opens its argument by asserting:

> Valero seeks to avoid its obligations under [the take-or-pay] provision by asserting that the Railroad Commission gas market demand rule *abrogates* the take-or-pay provision by limiting Valero's obligation to take gas to its market demand and consequently relieves Valero of its obligation to pay for the Daily Contract Quantity of gas not taken. It is Appellants' position that as a matter of law the Railroad Commission gas market demand rule does not affect the rights and obligations of the parties to this Contract by relieving Valero of its obligations to pay for this minimum quantity of gas provided by the Contract.

(Appellants' Brief, p. 11) (emphasis supplied.)

Lively is purely and simply "setting up a straw man and knocking it down." Whether the Gas Market Demand Rule unilaterally *abrogates* the take-or-pay provision is *not the issue* in this appeal. In *this* Contract, the *quantity* of gas Valero is required to take *or pay for* is *defined* as an amount "available for delivery," "not exceeding the maximum . . . rate of flow permitted by [Commission] rules." (P. Ex. 1, p. 3, art. I[j].)

As explained in § IIIB, *supra,* the take-or-pay provision requires Valero to take or pay for 90% of Seller's daily Deliverability. Deliverability is defined in the Contract as the "quantity of gas which Seller has *available for delivery . . . but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.*" Thus, the *Contract* itself states that Commission rules and regulations can limit Valero's obligation to take *and* its alternative obligation to pay. The Contract

does not require Valero's *payment* for a minimum quantity of gas as measured in Mcfs or Btus; it requires payment for a certain *percentage* of "Deliverability," a defined term that embodies the concept that it is limited by Commission rules and regulations.

Lively's entire argument under its First and Second Points of Error, the *bulk* of its Brief, is therefore based on a faulty premise, in an attempt to divert this Court's attention from the plain words of the Contract. Whatever contract Lively's Brief discusses, it is not this one. In essence, through its lawsuit Lively sought to *rewrite* and engraft into the Contract a provision the parties did not include.

B. *Lively's Specific Arguments.*

Under its First and Second Points of Error, Lively initially discusses its irrelevant proposition that "[t]he gas market demand rule and associated ratable take requirements relate to the *production* and *taking* of gas. . . . They do not regulate the payment for gas not taken. . . ." (Lively's Brief, p. 11.) Lively cites an unpublished district court judgment in *Dallas Production Co. v. Railroad Commission*, No. 260,641 (District Court of Travis County, 53rd Judicial Dist. of Texas, June 10, 1977), in which the court stated that the Commission had exceeded its statutory authority by issuing an order that any provisions inconsistent with the Gas Market Demand Rule were "rendered inoperative," including "obligations requiring gas purchasers to take, or pay for if not taken, quantities greater than allowable set by this Commission."

To the extent that an unreported district court judgment could be considered by this Court, however, it is irrelevant, since the plain terms of the Contract limit *Deliverability* to the amount the Commission allows Lively to produce and Valero to take. Whether the Commission has the authority unilaterally to render take-or-pay provisions "inoperative" is an immaterial inquiry.

Lively next invokes the preamble to the most recent formulation of the Gas Market Demand Rule as adopted by the Commission in March of 1987, even though at trial Lively vigorously objected to evidence concerning the recent version. (S.F. 690.) The preamble states that recent amendments to the Gas Market Demand Rule "shall not affect existing contractual rights and obligations between parties." As shown, however, the Contract clearly defines Valero's obligations to take *or* pay as limited by the amount Lively can legally produce and Valero can legally take. The wording of the preamble is again irrelevant to Valero's purchase obligation under the language of the Contract.

Lively also cites several unpublished district court summary judgments purporting to undermine a gas market demand rule defense. Aside from the fact that these one-page conclusory judgments provide no precedent for this Court, they are predicated on different facts and different contracts.[5] The judgments contain no indication that the contracts at issue in those cases *specifically* limited the obligation to pay, as well as the obligation to take, to the maximum quantity of gas

5. In fact, the district court in this case *withdrew* a summary judgment (Tr. 29) and denied a second motion for summary judgment recognizing there were material fact issues ripe for jury consideration.

"available for delivery," "not exceeding" the amount Valero can legally take and Lively can legally produce.

Lively's next argument seems to be simply that the Contract is unfair, since "[u]nder Valero's contention, Valero's takes will always equal deliverability, and there can never be a deficiency under the take-or-pay provision of the Contract requiring Valero to pay for gas not taken." (Brief of Appellants, p. 15.) Lively goes on to argue that Valero thus "fails to recognize the purpose and effect of alternative performance obligations. . . ." (*Id.*)

Again, Lively's argument has no relevance to *this* Contract, in which *both* of *Valero's* alternative methods of performance are tied to the Contract's definition of "Deliverability." Lively cites cases it claims support its argument that an alternative obligation to pay is not relieved by an inability to take, but *none* of these cases involved contracts such as this one where Valero's alternative obligation to pay is *expressly* limited to payment for the quantity it can take. Lively itself concedes that an alternative obligation to pay could be excused by "some specific contract language so providing." (Lively's Brief, p. 18.) Such specific contract language exists in this case.

Finally, Lively asserts that "if the gas market demand rule has the effect asserted by Valero, the take-or-pay provision . . . becomes meaningless," and cites case authority holding that "parties to an instrument generally intend that every clause has some effect and purpose." (Lively's Brief, p. 19.) Lively adds that Valero's interpretation would "deprive Lively of the protection of that important provision." (*Id.*, p. 20.) First, the Gas Market Demand Rule was adopted *after* the Contract

was signed (S.F. 113, 1517); the parties' intent as evidenced by the Contract was clearly to provide for a limitation on an obligation to pay for gas not "Deliverable" pursuant to applicable rules and regulations. It is *Lively* who seeks to deny effect and purpose to critical clauses of the Contract — the Deliverability definition and the take-or-pay clause considered in light of that definition. As Lively's cited authorities hold, this Court cannot change or engraft a new provision onto this Contract redefining "Deliverability."

Moreover, the Gas Market Demand Rule affords Lively the *exact* protection the take-or-pay provision was meant to afford — from discrimination in takes.

In truth, it is Lively's interpretation of the take-or-pay clause that is unfair and unreasonable. Lively characterizes the take-or-pay clause as a producer's *insurance policy* against any downturn in the market, even an unforseen downturn of dramatic proportions changing the nature of the industry. Under Lively's interpretation, it would be entitled to *payment* for gas that it cannot even deliver under applicable rules and regulations. Clearly, the parties did not intend that the pipeline should bear the entire brunt, with no adverse effects on the producer, of the type of decline currently existing in the natural gas market. Such an interpretation is not only egregiously unfair, it is incorrect under the plain terms of the Contracts.

As a final note, Lively conclusorily states that this Court's recent opinion in *Kodiak 1981 Drilling Partnership v. Delhi Gas Pipeline Corp.*, No. 04-84-00499-CN (Tex. App. — San Antonio, May 13, 1987) (not yet reported), is inapplicable. In *Kodiak*, this Court affirmed

a take-nothing judgment against a producer on a take-or-pay provision in a gas purchase contract. The Court held that the pipeline's obligation to take or pay for gas had been suspended by events of *force majeure* as defined in the contract. Because *Kodiak* undermines Lively's position completely, including its argument that alternative obligations to pay are not excused by an inability to take, Lively lamely seeks to distinguish *Kodiak*. First, Lively states that the jury in this case did not make a finding that Valero's performance was excused by virtue of the *force majeure* provision. The jury was given a copy of the Contract, however, and could well have concluded that *force majeure* precluded liability.

Lively also contends that the *force majeure* clause in *Kodiak* differs from that involved in the Contract here. In fact, the *force majeure* clauses are very similar, in that both specify failure of markets as a condition of *force majeure*. The evidence was uncontroverted at trial that Valero's market for Lively's gas had drastically failed, and that Valero had taken all the gas from Lively for which it had a downstream market demand. (S.F. 568, 571, 1040, 1483-84; D. Ex. 11A, 38, 64.) Thus, *Kodiak* is directly applicable. Moreover, another Texas court recently ruled that cessation of production when wells are shut in under Commission orders is an event of *force majeure*. *Frost National Bank v. Matthews*, 713 S.W. 2d 365 (Tex. App.—Texarkana 1986, writ ref'd n.r.e.) (*force majeure* clause prevented termination of lease). Thus, an inability to take can be *force majeure*.

C. *Conclusion.*

In conclusion, Lively's entire argument under its First and Second Points of Error fails to address the express

provisions of the Contract, and thus underscores that the trial court's judgment should be affirmed.

V. THE INSTRUCTION ON "DELIVERABILITY"

Third Reply Point of Error (Restated):

THE TRIAL COURT DID NOT ERR IN DEFINING THE TERM DELIVERABILITY USED IN INSTRUCTION 2 TO SPECIAL ISSUE 2 (Reply to Appellants' Points of Error Three and Four).

The trial court properly defined the term "Deliverability" in its Instruction 2 under Special Issue No. 2. In fact, the definition submitted by the trial court was the exact definition *Lively* requested.

A. *Lively Failed to Preserve Any Alleged Error.*

In Appellants' Brief, *for the first time ever,* Lively complains of the trial court's instruction to the jury on the meaning of "Deliverability," an instruction Lively itself submitted. Lively contends that the trial court should have characterized language on Deliverability *testing* in the take-or-pay clause as a *definition* of "Deliverability," instead of employing the definition in the "Definitions" section of the Contract.

Lively has no standing to belatedly complain of this instruction on appeal. Lively submitted the *exact* definition of which it now complains! (Tr. 66, 73.) Lively never requested additional or substitute language on "deliverability" from Article V, § 5, nor did Lively at trial object to the definition as worded (presumably since it submitted it). (S.F. 1673-90, Tr. 66, 73.) Therefore, Lively's complaint of error is *waived*. Tex. R. Civ. P. 274;

State v. Harrington, 407 S.W.2d 467, 479 (Tex. 1966), *cert. denied,* 386 U.S. 944, 87 S. Ct. 977 (1967). *State v. Lackey,* 576 S.W.2d 685, 688-89 (Tex. Civ. App.—San Antonio 1979, writ ref'd n.r.e.); *Adam v. Harris,* 564 S.W.2d 152, 156 (Tex. Civ. App.—Houston [14th Dist.] 1978, writ ref'd n.r.e.); *Southwestern Bell Telephone Co. v. Ramsey,* 542 S.W.2d 466, 476 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.). A party cannot predicate error on instructions given at his own request. *McFadden Publications, Inc. v. Wilson,* 121 S.W.2d 430, 433 (Tex. Civ. App.—El Paso 1938, writ ref'd).

In its Brief, Lively disingeniously claims it "objected to the Trial Court's submission to the jury of Special Issue 2 and its accompanying instructions (S.F. 1675), thereby preserving error." (Appellant's Brief, p. 22). However, an objection to an instruction must be specific and distinct to preserve error for appeal. *Mahan Volkswagen, Inc. v. Hall,* 648 S.W.2d 324, 330 (Tex. App.—Houston [1st Dist.] 1982, writ ref'd n.r.e.); *Southwestern Bell Telephone Co.,* 542 S.W.2d at 476. Reference to S.F. 1675 discloses only a general objection to the submission of Special Issue No. 2 on the purported grounds that it was not a controlling issue, not on grounds that it contained an improper definition of deliverability. In fact, the Record discloses no such objection in the entirety of Lively's objections to the charge, presumably because Lively submitted the precise definition used. (S.F. 1673-90.)

B. *The Definition Was Proper.*

The trial court's instruction, moreover, was entirely proper. The *definition* of Deliverability is contained in the "Definitions" article of the Contract, Article I. The

most logical construction of the Contract, and the one the trial court obviously adopted, is that the reference to Deliverability in the take-or-pay provision merely refers to a method for measuring physical deliverability; it is not the *definition* of Deliverability, and certainly does not *supplant* the language in the Deliverability definition that Deliverability in no event exceeds the maximum legal production.

Last, Lively argues that the explanatory instruction on Deliverability required the answer to a question of law—whether the Gas Market Demand Rule modified existing contractual relationships between private parties. As noted, *Lively* submitted the instruction, which in any event does not require the jury to answer a question of law. It rather provides the jury with necessary background to determine the fact question of whether Valero failed to take the DCQ under the Contract, in light of Valero's evidence on its market demand for Lively's gas and the effect of the Rule.

Therefore, the instruction on Deliverability was entirely proper, and clearly did not cause the rendition of an improper judgment.

VI. THE TRIAL COURT'S OTHER INSTRUCTIONS TO SPECIAL ISSUE NO. 2

Fourth Reply Point of Error (Restated):

THE TRIAL COURT'S INSTRUCTIONS TO SPECIAL ISSUE 2 WERE ENTIRELY PROPER AND WERE NOT PREJUDICIAL COMMENTS ON THE WEIGHT OF THE EVIDENCE (Reply to Appellants' Point of Error Five).

In its Fifth Point of Error Lively cavils with several specific Instructions given under Special Issue No. 2. All of these instructions were proper, and could not have caused the rendition of an improper judgment.

A. *Instructions Relating to Waste.*

First, Lively complains that the following Instructions constituted "prejudicial comments on the weight of the evidence":

> The term "market demand" means that amount of gas needed for current consumption.
>
> You are instructed that the production, transportation, or use of gas in a manner, in an amount, or under conditions which constitute waste is unlawful and is prohibited.
>
> You are instructed that the term "waste" includes the production of gas in excess of transportation or market facilities or reasonable market demand for the type of gas produced.

(Tr. 200.)

These Instructions mirror language in the Texas Natural Resources Code and *Railroad Commission v. Woods Exploration & Producing Co.*, 405 S.W.2d 313, 318 (Tex. 1966), and were entirely proper. First, they were directly relevant to whether Valero had failed to take the DCQ under the Contract. As explained, DCQ is a function of *Deliverability*, which is the amount of gas "available for delivery," not exceeding maximum legal production. The jury was presented evidence on the absence of Valero's market demand for Lively's gas. (S.F. 531-34, 540, 565-71, 602, 1040, 1332.) These Instructions enabled the jury to place this evidence

in the context of applicable rules and regulations, and thus in the context of the Deliverability clause.

Moreover, Lively does not explain how these Instructions, even if irrelevant, "nudged" the jury against Lively. Lively implicitly concedes that these Instructions are correct statements of the law. In truth, Lively's objection to these Instructions is based on the same faulty premise pervading its Brief: that the issue in this case is whether the conservation statutes and Commission rules unilaterally abrogate the take-or-pay provisions. Lively asserts: "There are no conservation statutes prohibiting Valero from paying even when it cannot take the gas." (Brief, p. 25.) The point, however, is that the *Contract* limits Valero's obligation to pay to payment for gas it can legally take. It cannot legally take gas in excess of its downstream market demand, because production of such gas would be "waste." Thus, these Instructions are directly relevant and cannot constitute harmful error. *See First State Bank & Trust Co. of Edinburg v. George,* 519 S.W.2d 198, 207 (Tex. Civ. App. — Corpus Christi 1974, writ ref'd n.r.e.).

A comment on the weight of the evidence occurs only when the judge assumes the truth of a material controverted fact, or exaggerates, minimizes, or withdraws some pertinent evidence from the jury's consideration. *Hirdler v. Boyd,* 702 S.W.2d 727, 729-30 (Tex. App. — San Antonio 1986, writ ref'd n.r.e.). In deciding whether an instruction constitutes an impermissible comment on the weight of the evidence, the Court must consider the charge as a whole. *Id.* at 730. To form a ground for reversal, a comment must be one that would probably cause the rendition of an im-

proper judgment. *Id.* The Court may incidentally comment when necessary or proper as part of an explanatory instruction or definition. *Id.* Statutory duties *should* be handled by instruction. *See Southern Pacific Co. v. Castro,* 493 S.W.2d 491 (Tex. 1973). Under these standards, this Court could not have committed reversible error submitting Instructions that are correct statements of the law.

Again, Lively's complaint is a red herring to avoid the real issue: that wasteful takes are prohibited by Texas law and the Gas Market Demand Rule, and therefore that the definition of Deliverability does not require Valero to take or pay for *quantities* of gas that would be "wasteful" if produced.

B. *The Instruction Relating to Article V, ¶ 5.2.*

Lively also complains that the following instruction, which tracked Article V, ¶ 5.2 of the Contract, constituted an impermissible comment on the weight of the evidence:

> You are instructed that the Contract provides that subject to its other provisions, Valero shall have the right to purchase such quantity of gas per day as Valero may from time to time elect to purchase up to the total quantity per day which the wells are capable of producing when produced at their respective maximum efficient rates of flow, in Lively's sole judgment reasonably exercised, or at their respective allowable rates of flow under applicable orders, rules, regulations or laws, whichever is the lesser rate of flow.

(Tr. 199.)

Lively claims that this Instruction was prejudicial because it somehow implied that Valero controls the quantity of gas it is required to take or pay for.

This provision simply means what it says, and makes no additional implication. The jury was given the entire Contract; an Instruction as to one of its terms clearly was not prejudicial error causing an improper judgment. It is relevant to Special Issue No. 2 because it shows the parties' intention that Valero be bound by applicable regulations and laws.

VII. THE CONDITIONAL SUBMISSION OF SPECIAL ISSUE NO. 3

Fifth Reply Point of Error (Restated):

THE TRIAL COURT DID NOT ERR IN CONDITIONALLY SUBMITTING SPECIAL ISSUE THREE (Reply to Appellants' Point of Error Six).

Lively contends that the Court erred in conditionally submitting Special Issue No. 3. Lively argues that each party is entitled to have submitted the controlling issues for each ground of recovery or defense, that Special Issue No. 3 was a controlling issue, and that because the jury answered "No" to Special Issue "No. 2," conditional submission deprived Lively of a chance for the jury to answer the controlling issue.

Special Issue No. 2 inquired:

> Do you find that Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)?

(Tr. 145.)

Special Issue No. 3 inquired:

> What sum of money, if any, if paid now in cash, do you find to be due and owing to Lively under the Contract?

(Tr. 147.)

Both Special Issue No. 2 and Special Issue No. 3 were accompanied by various Instructions.

Lively's argument is meritless. The central issue of its take-or-pay claim was whether Valero failed to take or pay for the Daily Contract Quantity of gas. Lively's own Brief *sums up* its claim against Valero as follows:

> Lively alleged that Valero breached its obligations under the contract *by failing to take delivery of and pay for the Daily Contract Quantity of natural gas* during certain contract years *or pay for such Daily Contract Quantity of natural gas whether taken or not.*

(Brief, p. 2) (emphasis supplied.) Special Issue No. 2 made this controlling inquiry. Special Issue No. 3 merely inquired as to the amount of damages in the event the jury answered Special Issue No. 2 in the affirmative.

In its own Brief, Lively describes a "controlling issue" as an "ultimate issue," as distinguished from a "evidentiary issue" which "tend[s] only to establish the fact of the controlling issue." (Lively's Brief, p. 28.) Special Issue No. 2 clearly did not merely "tend to establish the fact of the controlling issue," it *was* the controlling issue determining dispositively that Varelo had no liability under the take-or-pay provisions of the Contract.

To argue that "Lively's entire take or pay cause of action was submitted conditionally" is simply absurd.

(Lively's Brief, p. 29.) Surely Lively would not argue that, once the jury had determined Special Issue No. 2 in the negative, there were any further inquiries necessary on the take-or-pay claim. The conditional submission of Special Issue No. 3 was proper, and could not have caused the rendition of an improper judgment.

Since Lively's argument does not make sense, it is not surprising that no Texas cases support its position. Lively cites no authority holding that if a dispositive issue is answered in the negative, a plaintiff is entitled nonetheless to have additional issues answered that the negative answer render immaterial to the Court in entering Judgment.

VIII. THE OVERWHELMING EVIDENTIARY SUPPORT FOR THE JURY'S FINDING AND THE JUDGMENT

Sixth Reply Point of Error (Restated):

THE TRIAL COURT PROPERLY ENTERED JUDGMENT FOR VALERO ON THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY, BECAUSE THERE WAS SOME EVIDENCE TO SUPPORT THE JURY'S FINDING (Reply to Appellants' Point of Error Seven).

Seventh Reply Point of Error (Restated):

THE TRIAL COURT PROPERLY ENTERED JUDGMENT ON THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY BECAUSE THE EVIDENCE IN SUPPORT OF THAT FINDING WAS LEGALLY CORRECT AND FACTUALLY SUFFICIENT TO SUPPORT THE FINDING (Reply to Appellants' Point of Error Eight).

Eighth Reply Point of Error (Restated):

THE TRIAL COURT PROPERLY ENTERED JUDGMENT ON THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY BECAUSE THE FINDING WAS AMPLY SUPPORTED BY THE EVIDENCE, AND WAS NOT AGAINST THE GREAT WEIGHT AND PREPONDERANCE OF THE CREDIBLE EVIDENCE (Reply to Appellants' Point of Error Nine).

Lively's Points of Error Seven through Nine each involve the evidentiary support for the jury's answer to Special Issue No. 2.

Lively contends: (1) there was no evidence to support the jury's answer to Special Issue No. 2; (2) there was insufficient evidence to support the jury's answer to Special Issue No. 2; and (3) the jury's answer to Special Issue No. 2 was against the great weight and preponderance of the evidence.

The evidence supporting the jury's answer to Special Issue No. 2 is not only sufficient, it is overwhelming, and compels affirmance of the trial court's judgment.

A. *The Standard of Review.*

1. *"No Evidence" or "Legal Insufficiency" Points of Error.*

In reviewing "legal insufficiency" or "no evidence" points, the Court must consider only that evidence and reasonable inferences drawn therefrom in their most favorable light to support the jury's findings, rejecting all contrary or conflicting evidence and inferences. *King v. Bauer,* 688 S.W.2d 845, 846 (Tex. 1985); *Glover v.*

Texas General Indemnity Co., 619 S.W.2d 400, 401 (Tex. 1981); *Ray v. Farmers State Bank of Hart*, 576 S.W.2d 607, 609 (Tex. 1979); *Alterman v. Frost National Bank of San Antonio*, 675 S.W.2d 619, 620 (Tex. App.—San Antonio 1984, no writ). A "no evidence" point will not be sustained if there is *any* probative evidence to support the jury's finding. *Ray*, 576 S.W.2d at 609.

2. *"Factual Insufficiency" and "Great Weight and Preponderance" Points of Error.*

In passing on a complaint of insufficient evidence, a court must consider all the evidence and reverse only if the jury's decision is so clearly against the great weight and preponderance of the evidence as to render the judgment clearly wrong and manifestly unjust. *Pool v. Ford Motor Co.*, 715 S.W.2d 629, 634-35 (Tex. 1986); *In Re King's Estate*, 150 Tex. 662, 244 S.W.2d 660, 661 (1951); *Alterman*, 675 S.W.2d at 621.

An appellate court may not substitute its opinion for the jury's merely because it might have reached a different fact conclusion. *Thompson v. Wooten*, 650 S.W.2d 499, 501 (Tex. App.—Houston [14th Dist.] 1983, writ ref'd n.r.e.). Nor may an appellate court pass on the credibility of witnesses or the weight to be given their testimony. *Rego v. Brannon*, 682 S.W.2d 677, 680 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.).

B. *The Evidence in the Record.*

The evidence supporting the jury's answer to Special Issue No. 2 is in fact essentially uncontroverted. First, the Record demonstrates that Valero purchased from

Lively all the gas Lively could legally produce during the Contract years at issue, and thus purchased the DCQ as defined in the Contract. Second, Lively's own "evidence" glaringly failed to prove its case, even under Lively's erroneous theory that G-10 tests should determine deliverability instead of the express Contract definition.

1. *The Evidence Showed that Valero Took and Paid For the Daily Contract Quantity.*

As thoroughly explained in Section IIIB, *supra*, the Contract requires Valero to take or pay for 90% of the "quantity of gas [Lively] has available for delivery," "not exceeding the maximum . . . rate of flow permitted by [Commission regulations]." At trial Valero presented extensive testimony proving it had taken the DCQ under the Contract. Lively's Brief does not refute this evidence, nor did Lively succeed in controverting it at trial.

(a) *The Meaning of the Gas Market Demand Rule.*

Because the Contract does not obligate Valero to take or pay for gas not legally deliverable under the Gas Market Demand Rule, Valero introduced the 1978 Gas Market Demand Rule and offered *undisputed* testimony from former Commission Chairman Poerner and Parish, Valero's Director of Proration and Producer Affairs, concerning the Rule's adoption and meaning. (S.F. 1472-1557; 675-699; D. Ex. 7.) The substance of their testimony is set forth in Section IIIC, *supra*. To briefly reiterate, the Rule: (i) requires Valero to purchase only a proportionate share of a producer's downstream market demand, to allocate its purchases "ratably" among its producers, and to purchase various

defined categories of gas in a specified order of priority; and (ii) proscribes Lively from producing more gas than its ratable share, in accordance with the priority categories, of its purchaser's downstream market demand. (D. Ex. 7, 20-21; S.F. 324-25, 689, 693, 710, 910, 935, 989, 1007, 1050, 1494, 1552, 1556.)

(b) *Valero's Compliance with the Gas Market Demand Rule.*

Valero then showed that it had purchased from Lively the maximum quantity under the Rule, and thus took the DCQ as defined in the Contract.

(i) *Valero's Downstream Market Demand Has Dramatically Declined.*

First, Valero established through *unrebutted* evidence that its downstream market demand had declined to a point where it had been forced to drastically curtail purchases from its producers, including Lively.

Alan Anderson ("Anderson"), a specialist in natural gas economics with a Ph.D. in economic history from Johns Hopkins, and Valero's President, Becraft, explained at trial that a natural gas "market" is a function of *price*. (S.F. 533, 554, 1005.) The Commission requires Valero to charge an *inflexible* price for its gas equal to the weighted average of gas ("WACOG") plus $0.15. (S.F. 555, 571; D. Ex. 12.)[6] Over the past few years Valero's WACOG plus $0.15 has equalled $4.00 to $4.20

6. This requirement is contained in the Final Order in Gas Utilities Docket No. 500 dated September 4, 1979 ("Final Order") (D. Ex. 12; S.F. 556-59). The Appendix to the Final Order describes in great detail the WACOG calculation. (*See also* S.F. 570-71.)

per MMBtu of natural gas. (S.F. 555.) Therefore, Valero's sales market is the market for $4.00 gas. (*Id.*)

That market is currently virtually nonexistent. Due to many factors, including a reduction in industrial consumption and governmental policies adversely impacting demand, a natural gas glut arose approximately in 1981. (S.F. 602, 710, 713, 1040, 1495, 1483-84; D. Ex. 11A, 13A, 38, 94.) Prices for natural gas have fallen accordingly, currently to $1.50 per MMBtu. (S.F. 537.) Thus, Valero's customers can purchase gas, or use alternative fuels, at significantly lower prices than the $4.00 and above that Valero is required to charge them. (S.F. 529-34, 1012; D. Ex. 32.) As customers' contracts with Valero have expired, they have sought cheaper fuel elsewhere. (S.F. 529-34.) Valero's market has been drastically reduced. (S.F. 540, 568; 1040, 1532; D. Ex. 11A, 13A, 38, 64.) Its sales have declined from 620 billion cubic feet of gas in 1981 to 70 billion in 1986. (S.F. 540.) At the same time, its WACOG, including cost of service, has *increased.* (S.F. 571; D. Ex. 11A, 13A.)

The downstream market demand for $4.00 gas, which is Valero's market as established by the Commission, is purely and simply drying up. (S.F. 540, 568, 1040, 1532; D. Ex. 11A, 13A, 38, 94.)

(ii) *Valero's Nominations from Lively and its Other Producers Are in Accordance with its Downstream Market Demand.*

It is undisputed that *Valero has taken all of the gas available to it from Lively consistent with Valero's downstream market demand.* (S.F. 684.)

Parish explained that Valero scrupulously follows the procedures required by the Rule and set forth in § IIIC (2), *supra*. In fact, Valero has implemented a computerized system to mathematically apportion Valero's gas purchase requests ratably among its producers across its system, and in accordance with the priority categories. (*Id.*) (S.F. 676-78, 682-85, 695-99, 1307, 1310-11, 1318-21; D. Ex. 16, 17, 18, 19, 61, 62.)

Valero introduced numerous exhibits, explained by Parish, demonstrating systemwide ratability in accordance with the priority categories. (D. Ex. 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 74; S.F. 684, 1329-32, 1346-53, 1376.) In sum, his exhibits demonstrated that during the Contract years in issue Valero has been ratable in its nominations and rate requests required by the Gas Market Demand Rule. (S.F. 1376.)

Valero's purchases from Lively have been reduced to virtually zero because Lively produces primarily gas well gas (S.F. 209, 693), non-priority gas, and Valero's market demand has dropped *below* the amount of *priority* gas deliverability. (D. Ex. 63, 64; S.F. 1328-31.) Thus, Valero must satisfy its market demand exclusively through ratable purchases from producers of higher-priority gas (S.F. 1324-25.) *Valero's nominations have been ratable among the non-priority gas producers.* (S.F. 1332; D. Ex. 64.)

In sum, Valero's uncontroverted evidence showed that it has taken all the gas from Lively "available for delivery," "not exceeding the maximum . . . [production] . . . permitted by [Commission] regulations." Therefore, Valero took and paid for the DCQ under the Contract, and the jury so found.

POINT 4. The Court of Appeals erred in holding that the obligations of Valero under the take-or-pay provision of the contract are controlled by the definitions of "Daily Contract Quantity" and "Deliverability" set forth in Article I of the contract.

[Germane to: Special Issue No. 2 (Tr. 145-146); Point of Error 1, Appellants' Motion for Rehearing.]

POINT 5. The Court of Appeals erred in holding that the Trial Court properly submitted to the jury Special Issue No. 2 and Instruction No. 2 containing the definition of "Deliverability" from Article I(j) of the contract.

[Germane to: Special Issue No. 2 (Tr. 145-146); Point of Error 9, Appellants' Motion for Rehearing.]

POINT 6. The Court of Appeals erred in holding that Lively waived their objection to Special Issue No. 2 and Instruction No. 2 containing the definition of "Deliverability" from Article I(j) of the contract.

[Germane to: Special Issue No. 2 (Tr. 145-146); Point of Error 10, Appellants' Motion for Rehearing.]

POINT 7. The Court of Appeals erred in holding that the instructions to Special Issue No. 2 were relevant, were not a comment on the weight of the evidence, and did not cause the rendition of an improper judgment.

[Germane to: Special Issue No. 2 (Tr. 145-146); Plaintiffs' Motion for Judgment and Partial New Trial, ¶ 7 (Tr. 160-163); Points of Error 11 and 12, Appellants' Motion for Rehearing.]

POINT 8. The Court of Appeals erred in holding that the Trial Court fairly submitted Special Issue No. 2, which was the controlling issue, and properly conditionally submitted Special Issue No. 3, which was the damage issue.

[Germane to: Special Issues No. 2 and 3 (Tr. 145-147); Plaintiffs' Motion for Judgment and Partial New Trial, ¶ 7 (Tr. 160-163); Point of Error 15, Appellants' Motion for Rehearing.]

POINT 9. The Court of Appeals erred in holding that Lively conceded that the evidence of the Gas Market Demand Rule supports the jury finding in Special Issue No. 2.

[Germane to: Point of Error 17, Appellants' Motion for Rehearing.]

Point 10. The Court of Appeals erred in holding that there was evidence to support the jury's finding on take-or-pay liability.

[Germane to: Plaintiffs' Motion for Judgment and Partial New Trial, ¶ 7 (Tr. 160-163); Point of Error 18, Appellants' Motion for Rehearing.]

POINT 11. The Court of Appeals erred in holding that legally incorrect evidence can be relied upon to support the jury's finding on take-or-pay liability.

[Germane to: Point of Error 19, Appellants' Motion for Rehearing.]

POINT 12. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to

relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals is pre-empted by the Natural Gas Policy Act.

[Germane to: Point of Error 23, Appellants' Motion for Rehearing.]

POINT 13. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals violates the Commerce Clause of the United States Constitution.

[Germane to: Point of Error 24, Appellants' Motion for Rehearing.]

FACT STATEMENT

This is a general fact statement germane to all points.

The contract in question (P. Ex. 1, S.F. 115) was entered into in 1973 between Lively and Valero's predecessor, Lo-Vaca Gathering Company. It grants to Valero the exclusive right and the obligation to purchase all of Lively's gas from the Contract Area for a period of 20 years.

The contract provides that Valero will, for each Contract Year, either (1) take delivery of and pay for the Daily Contract Quantity of natural gas or (2) pay for the Daily Contract Quantity of natural gas, whether taken or not. The Daily Contract Quantity is defined as a quantity of gas equal to ninety percent (90%) of Lively's

daily deliverability of gas averaged over the Contract Year. The quantity of gas to be purchased by Valero taken or not. The Daily Contract Quantity is defined as a each Contract Year is determined by multiplying the Daily Contract Quantity by the number of days during the Contract Year during which Valero's performance was not excused by the contract.

Article V, ¶ 5.3, of the contract provides in pertinent part as follows:

> Subject to the other provisions hereof, Buyer agrees to purchase and pay for (*or*, if Buyer's performance hereunder is not excused by other provisions of this Agreement, *pay for, if available, whether taken or not*) during the days of each contract year of the term hereof *a Daily Contract Quantity of gas from Sellers' Lands and Leases in the Contract Area equal to ninety percent (90%) of Sellers' daily Deliverability of gas hereunder.* Upon request by Buyer or Seller, *Sellers' Deliverability shall be determined and established by Buyer by testing the actual ability of Sellers' wells to deliver into Buyer's facilities at the points of delivery;* provided, however, neither Seller nor Buyer shall request such Deliverability test more often than once in any ninety (90) day period. Such Deliverability tests shall be made after a stabilized rate of flow has been achieved against such pressure as is required to deliver into Buyer's facilities at the operating pressure at the points of delivery at the time of the test. . . .[2]

This provision in the contract is commonly known in the oil and gas industry as a "take or pay" clause. Mr. Lively testified that he would not have executed the contract if this provision had not been included (S.F. 121).

2. Emphasis added throughout except where indicated otherwise.

The contract also contains a general definition of the term "deliverability" which differs from the specific use of that term in the take-or-pay provision quoted above. Article I(j) of the contract defines the term "deliverability" as:

> [T]hat quantity of gas which Seller has available for delivery from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction. Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects to take hereunder up to the maximum quantity which in accordance with good engineering and gas production practice can be produced from Seller's wells in the fields.

Beginning with the 1982 Contract Year (June 1, 1982 - May 31, 1983), and continuing through the 1985 Contract Year, Valero failed to either take and pay or simply pay for the minimum quantity of gas as required by the contract.

Pursuant to Article VIII, ¶ 8.2, of the contract, Lively calculated the amount due from Valero under the take-or-pay provision to be $21,264,689.30 (P. Ex. 51; S.F. 398).

Article VIII, ¶ 8.2, provides:

> If Buyer shall fail in any contract year of the term hereof to take the quantity of gas that Buyer is obligated to take hereunder, then Seller shall, within sixty (60) days after such contract year render a bill to Buyer based upon the weighted average price, including tax reimbursement, in effect hereunder during the contract year in which such deficiency occurred, computed on the volumes delivered during the year and at the price, including tax reimbursement, applicable to such volumes at the time of delivery thereof. If Buyer agrees with such statement, Buyer will make payment to Seller for the amount of such statement within sixty (60) days after receiving Seller's statement. In computing the amount due Seller for any deficiency in takes by Buyer occurring during any contract year, there shall be deducted from such deficiencies the following quantities:
>
> (a) The total of the quantities which Buyer requested, up to 111% of the Daily Contract Quantity, and which Seller failed to deliver for any reason on any day or days during such contract year; and,
>
> (b) The total of the quantities of gas which Buyer was unable to take or failed to take on any day or days during such contract year by reason of force majeure; and,
>
> (c) The total of the quantities of gas by which there was a deficiency in Seller's allowable for the wells covered hereby below the Daily Contract Quantity on any day or days during such year, excluding any portion of such deficiency which is caused by, or is a result of, Buyer's failure to nominate to the Texas Railroad Commission to purchase a quantity of gas equal to the Daily Contract Quantity; and

> (d) The total of the quantities of gas which Buyer refuses to take on any day or days during such year by reason of Seller's failure to meet any of the quality specifications or pressure requirements provided hereunder.

In asserting that it had no liability to Lively under the take-or-pay provision of the contract, Valero relied upon evidence that it took the amount of gas under the contract that it was authorized to take under the Gas Market Demand Rule of the Railroad Commission of Texas (S.F. 675-699, 1306-1377; D. Exs. 7, 78, 91; Tr. 45-50). The amount of gas Valero took under its contract with Lively was determined by Valero's market demand for gas as reflected in its monthly nominations for gas filed by Valero with the Railroad Commission (D. Exs. 62-62M).

The Trial Court submitted Lively's take-or-pay claim by way of two special issues to the jury. Special Issue No. 2 inquired whether "Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)" (Tr.145). Special Issue No. 3, concerning the amount of money that Valero owed to Lively for its failure to take or pay under the contract, was conditionally submitted by the Trial Court upon an affirmative finding being made by the jury to Special Issue No. 2 (Tr. 147). Since the jury answered Special Issue No. 2 in the negative, it did not answer Special Issue No. 3. On the basis of the jury's answer to Special Issue No. 2, the Trial Court entered judgment against Lively on its take-or-pay claim. Other special issues were submitted to the jury, and the part of the judgment incorporating the jury's findings on them was not appealed.

The Court of Appeals, in affirming the Trial Court's judgment, relied upon the general definition of "Deliverability" contained in Article I(j) of the contract and upon the government regulation clause in Article XIII, ¶ 13.1, making the agreement "subject to all valid applicable federal and state laws . . . and to the orders, rules and regulations of any federal or state regulatory body or authority having jurisdiction." (Court of Appeals' Opinion, pp. 3-4).

Plaintiffs' Exhibits 38-41 vividly show how Valero has manipulated its nominations of, and requests for, gas by comparing the quantities requested by Valero with the Daily Contract Quantities under the contract. During the period June 1, 1982 - May 31, 1986, the quantities requested by Valero were progressively reduced. During the 1985 Contract Year, the quantities requested by Valero averaged less than 1000 Mcf per day for 4 months and were virtually zero for 6 months, while the Daily Contract Quantity for that same period was 7080 Mcf per day.

SUMMARY OF ARGUMENT

This case should be reversed and judgment rendered that Valero is liable to Lively for its failure to pay for the Daily Contract Quantity under the contract for the Contract Years 1982, 1983, 1984, and 1985, and the case should be remanded for a new trial as to the amount owed to Lively by Valero.

The Trial Court and the Court of Appeals erred in failing to hold as a matter of law that Valero is not relieved of liability under the take-or-pay provision of the contract by the application of the Texas Gas Market

Demand Rule and in permitting the jury to pass upon this legal question. In so doing, the Court of Appeals ignored established rules of construction of contracts and in effect read out of the contract the important take-or-pay provision.

The courts below also erred in submitting, or approving the submission of, instructions to the jury in connection with Special Issue No. 2 which contained an improper definition of "Deliverability" for use in determining take-or-pay liability and were improper comments on the weight of the evidence which caused the rendition of an improper judgment. Error was committed in submitting Special Issue No. 2, which was not the controlling issue, and in conditionally submitting Special Issue No. 3, the controlling issue. Further, there was no evidence to support the jury's finding on take-or-pay liability, since the only evidence was legally incorrect.

The Court of Appeals' application of the Gas Market Demand Rule is invalid, because the Rule as applied by the Court is pre-empted by the Natural Gas Policy Act and violates the Commerce Clause of the United States Constitution.

ARGUMENT AND AUTHORITIES

POINTS OF ERROR 1-4. IN SUMMARY: THE COURT OF APPEALS ERRED IN HOLDING THAT THE TEXAS GAS MARKET DEMAND RULE APPLIED SO AS TO RELIEVE VALERO OF ANY TAKE-OR-PAY LIABILITY UNDER THE CONTRACT.

The effect of the judgment and the Court of Appeals' opinion is to hold that because of the Texas Gas Market

Demand Rule Valero has no liability to Lively under the take-or-pay provision of the contract. This is contrary to the clear and unambiguous provisions of the contract and the applicable rules of construction and has the effect of reading the take-or-pay provision out of the contract.

This is the first time a Texas court has made such a holding, and its ramifications are for reaching and will have a severe, adverse effect on gas producers in this state.

Article V, ¶ 5.3, of the contract contains the take-or-pay provision relied upon by Lively in this case. Valero seeks to avoid its obligations under that provision by asserting that the Railroad Commission Gas Market Demand Rule abrogates the take-or-pay provision by limiting Valero's obligation to take gas to its market demand and consequently relieves Valero of its obligation to pay for the Daily Contract Quantity when not taken. It is Petitioners' position that as a matter of law the Gas Market Demand Rule does not affect the rights and obligations of the parties to this contract by relieving Valero of its obligation to pay for the minimum quantity of gas provided by the contract.

Take-or-pay provisions have been recognized as standard provisions in gas purchase agreements since the early 1950's. 4 H. WILLIAMS & C. MEYERS, OIL & GAS LAW § 724.5 (1983). Courts have consistently held that such provisions are common in the industry and are not unconscionable or unfair. *Universal Resources Corp. v. Panhandle Eastern Pipeline Co.*, 813 F.2d 77 (5th Cir. 1987). The purpose of such clauses is to apportion the risks of natural gas production and sales between the seller and buyer. "The seller bears the risk of production.

To compensate seller for that risk, buyer agrees to take, *or pay for if not taken*, a minimum quantity of gas." *Universal Resources*, 813 F.2d at 80.

The Gas Market Demand Rule clearly does not relieve Valero of its alternative obligation to pay for the Daily Contract Quantity of gas as required by the take-or-pay provision of the contract. That rule and the associated ratable-take requirements relate to the *production* and *taking* of gas to prevent waste and protect correlative rights. They do not regulate the *payment* for as not taken under take-or-pay provisions of natural gas contracts. *Resources Investment Corp. v. Enron Corp.*, 669 F.Supp. 1038 (D. Colo. 1987). No Texas statute or Railroad Commission regulation, either expressly or by implication, prohibits or excuses a purchaser from *paying for* the quantity of gas for which that purchaser has contractually obligated itself to pay. Valero itself recognizes that there is nothing in the Gas Market Demand Rule that prevents Valero from paying for a deficiency when it exists by operation of the take-or-pay provision (S.F. 840).

The Railroad Commission and the courts have recognized that contractural obligations to pay for gas not taken are not superseded by the Gas Market Demand Rule.

An attempt by the Railroad Commission to declare by regulation that the Gas Market Demand Rule relieved purchasers of contractual take-or-pay obligations was held invalid almost immediately after its adoption. On February 22, 1977, the Railroad Commission issued an interpretive order relating to the Gas Market Demand Rule, in which the Commission attempted to declare that take-

or-pay provisions were invalid to the extent they contravened the provisions of that order. What has become known as the "penultimate paragraph" read as follows:

> IT IS FURTHER ORDERED that the provisions of any and all purchase or other agreements between producers and gas purchasers which contravene or are inconsistent with the provisions of this Order and [sic] are rendered inoperative, including, without limitation, provisions relative to (1) gas purchasers nominating to take gas in certain amounts or at certain levels, (2) producers asserting penalties, damages or other remedies against gas purchasers in the event of reductions in or cancellation of allowables and (3) *obligations requiring gas purchasers to take, or pay for it not taken, quantities greater than allowables set by this Commission.*

Railroad Commission Gas Well Allowable Order, 2 TEX. REG. 785, 788 (1977).

Three lawsuits were filed in the Travis County district courts challenging the validity of that order. In one of those cases, *Dallas Production Co. v. Railroad Commission*, No. 260,641 (Dist. Ct. of Travis County, 53rd Judicial District of Texas, June 10, 1977), the plaintiff asserted that the above-quoted paragraph was invalid because the Railroad Commission had exceeded its statutory authority by attempting to regulate take-or-pay contracts.[3] The Court held that the order was unlawful, invalid, and of no force and effect, stating:

> The Court further finds that the above quoted penultimate paragraph herein declared invalid does not affect the rights, duties or obligations of Brazos

3. Appendix at A1-A2.

> Electric Power Cooperative, Inc. and Brazos Fuel Company, Inc., Intervenors, and Plaintiff producers under the take or pay provisions of their gas purchase agreements.

The Railroad Commission did not appeal this judgment and subsequently repromulgated the order without the invalid paragraph, and it became regularly adopted as what is commonly referred to as the Gas Market Demand Rule. 3 TEX. REG. 324 (1978). That rule, with minor revisions, was in effect during the 1982-1986 period covered by this litigation.

From the history surrounding its adoption, it is plain that the Gas Market Demand Rule does not and cannot have the effect of overriding take-or-pay provisions in gas purchase agreements between producers and purchasers and does not provide a defense for the breach of those contractual obligations. This is clear from the Travis County district court's holding that the portion of the interpretive order which stated that the rule superseded private contractual provisions was invalid and the Railroad Commission's subsequent omission of the offending language in the replacement interpretive order.

In adopting the current Gas Market Demand Rule, Rules 30 and 34 (sections 3.30 and 3.34), the Railroad Commission again stated that such regulations were not intended to modify existing private contractual relationships. In the preamble to those rules, the Railroad Commission carefully describes the scope of those rules:

> Sections 3.30 and 3.34 are not intended to be a comprehensive statement of rights or obligations under the Common Purchaser Act, nor are they intended to preclude any complaints which may

> arise under that Act. *These amendments shall not affect existing contractual rights and obligations between parties.* 12 TEX. REG. 536 (1987).

The above history of the Gas Market Demand Rule is discussed in *Valero Transmission Co. v. Mitchell Energy Co.*, 743 S.W.2d 658 (Tex. App.—Houston [1st Dist.] 1987), where the Court held that the Railroad Commission's prorationing and ratable take system does not interfere with the terms of gas purchase contracts. The Court there held:

> Although the Texas Railroad Commission is given general statutory authority to regulate the production of gas, the Commission does not have authority to hear contract disputes or to abrogate the parties' respective rights under the gas purchase contract. *See Railroad Comm'n v. City of Austin*, 524 S.W. 2d 262 (Tex. 1975); *see also Humble Oil & Refining Co. v. Railroad Comm'n*, 133 Tex. 330, 128 S.W.2d 9 (1939); *Railroad Comm'n v. United Gas Pipe Line Co.*, 358 S.W.2d 907 (Tex. Civ. App.—Austin 1962, writ ref'd n.r.e.); A. Anderson, The Texas Approach to Gas Proration and Ratable Take, 57 U. Colo. L. Rev. 199, 220-21 (1986). Indeed, the Texas Railroad Commission, in adopting 16 Tex. Admin. Code secs. 3.30, 3.34 (1987), has itself expressly acknowledged that these rules "shall not affect existing contractual rights and obligations between parties." 12 TEX. REG. 536 (February 17, 1987).

Id. at 660.

The Court stated further:

> [A]s discussed above, the Railroad Commission has no authority to abrogate contract rights. Nor do the Railroad Commission rules purport to affect contract

Court took comfort in the fact that since the injunction required the taking of an "allowable" now set at zero, no violation of the law was taking place. *Valero Transmission Co.*, 743 S.W.2d at 665-66.

Lively also falsely claims that *Mitchell* undermines the effect of the *force majeure* clause in the Contract The *force majeure* clause in the *Mitchell* case, however, did not include "failure of markets" as a specified event of force majeure, as did the Lively Contract's *force majeure* clause. In *Kodiak 1981 Drilling Partnership v. Delhi Gas Pipeline Corp.*, 736 S.W.2d 715 (Tex. App. — San Antonio 1987, writ ref'd n.r.e.), this Court recently held that a *force majeure* provision specifying failure of markets as an event of *force majeure* relieved the pipeline of its take-or-pay obligation. *Kodiak* is directly on point, and eviscerates Lively's argument.

Lively contends that the take-or-pay provision is not "violative of any law or the Gas Market Demand Rule, because it does not require production but payment in lieu of production." (Motion, p. 8). Again, Lively misses the point. The Contract itself limits Valero's payment obligation to the amount that Lively can legally produce and Valero can legally take.

Lively asserts that the Court's opinion does not give effect to the take-or-pay provision. To the contrary, it is Lively that wholly disregards the Contract's plain terms and essentially asks this Court to impose payment obligations on Valero beyond those specified in the Contract. Therefore, the principles of contract construction set forth in the Motion (pp. 8-9) support Valero's position.

Each Contract stands on its own terms. This Court properly construed the Contract, and heeded its provisions

that limited Valero's payment obligation to the amount Lively could legally produce and Valero could legally take. Lively has never refuted that Valero took from Lively all the gas Lively could legally produce and Valero could legally take. Valero therefore complied with the Contract.

9. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT THE TRIAL COURT PROPERLY SUBMITTED TO THE JURY SPECIAL ISSUE NO. 2 AND INSTRUCTION NO. 2 CONTAINING THE DEFINITION OF THE TERM "DELIVERABILITY" FROM THE "DEFINITIONS" SECTION (ARTICLE I[j]) OF THE CONTRACT.

10. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT LIVELY WAIVED ITS OBJECTION TO SPECIAL ISSUE NO. 2 AND INSTRUCTION NO. 2 CONTAINING THE DEFINITION OF "DELIVERABILITY" FROM ARTICLE I(j) OF THE CONTRACT.

11. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT THE INSTRUCTIONS TO SPECIAL ISSUE NO. 2 WERE RELEVANT, WERE NOT A COMMENT ON THE WEIGHT OF THE EVIDENCE, AND DID NOT CAUSE THE RENDITION OF AN IMPROPER JUDGMENT.

12. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT IN CONSIDERING THE ENTIRE SET OF INSTRUCTIONS TO SPECIAL ISSUE NO. 2 AND THE ENTIRE CHARGE, THE INSTRUCTION CONTAINED IN THE THIRD PARAGRAPH OF THE INSTRUCTION TO SPECIAL ISSUE

NO. 2 WAS NOT A COMMENT ON THE WEIGHT OF THE EVIDENCE AND PROBABLY DID NOT CAUSE THE RENDITION OF AN IMPROPER JUDGMENT.

13. REPLY POINT OF ERROR: THE COURT CORRECTLY OVERRULED APPELLANTS' POINTS OF ERROR THREE, FOUR, AND FIVE.

Lively submitted the very instruction of "deliverability" of which it now complains. This alone justifies the Court's Opinion, and compels denial of its Motion.

Lively preposterously asserts that "when viewed in their entirety the extensive objections were sufficient and . . . there was no waiver that would preclude the consideration by this Court of the points of error contained in the Brief for Appellants and this Motion." (Motion, p. 13). Whether considered in their entirety, or separately, Lively's objections include *no objection* to the definition of "deliverability" in the charge. In fact, *Lively* submitted the definition, so it would be contradictory to impute an "objection" to a definition Lively submitted.

Moreover, for reasons discussed extensively in Appellee's Brief and the Opinion, the issue submission was entirely proper, and thus could not have nudged the jury in the wrong direction. *(See* Appellee's Brief, pp. 25-34).

15.* REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT THE TRIAL COURT FAIRLY SUBMITTED SPECIAL ISSUE NO. 2 AND PROPERLY CONDITIONALLY SUBMITTED SPECIAL ISSUE NO. 3.

* Lively presented no 14th point of error in its Motion.

16. REPLY POINT OF ERROR: THE COURT PROPERLY OVERRULED APPELLANTS' POINT OF ERROR SIX.

The response to these points of error is thoroughly addressed in Appellee's Brief. In sum, the ultimate and controlling issue was liability, the inquiry of Special Issue No. 2. Special Issue No. 2 is in fact worded almost exactly the way Lively described the central issue in its own Brief. *(See* Appellee's Brief, pp. 32-33). Conditioning submission of the damages issue upon an answer to the controlling liability issue was proper.

17. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT LIVELY CONCEDED THAT THE EVIDENCE OF THE GAS MARKET DEMAND RULE SUPPORTS THE JURY'S FINDING IN SPECIAL ISSUE NO. 2.

18. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT THERE WAS EVIDENCE TO SUPPORT THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY.

19. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT THERE IS LEGALLY SUFFICIENT EVIDENCE TO SUPPORT THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY.

20. REPLY POINT OF ERROR: THE COURT CORRECTLY REFUSED TO HOLD THAT THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY WAS AGAINST THE GREAT WEIGHT IN PREPONDERANCE OF THE EVIDENCE.

21. REPLY POINT OF ERROR: THE COURT CORRECTLY OVERRULED APPELLANTS' POINTS OF ERROR SEVEN, EIGHT, AND NINE.

22. REPLY POINT OF ERROR: THE COURT CORRECTLY AFFIRMED THE JUDGMENT OF THE TRIAL COURT.

As established in Appellee's Brief, the uncontroverted evidence in the Record demonstrates that Valero purchased from Lively all the gas Lively could legally produce during the contract years at issue, and thus purchased the "DCQ" as defined in the Contract. Moreover, Lively's own "evidence" glaringly failed to prove its case, even under Lively's erroneous theory that mechanical testing alone should determine "deliverability" instead of the express contract definition. (See Appellee's Brief, pp. 34-49).

23. REPLY POINT OF ERROR: THE COURT'S ACTION IN APPLYING THE TEXAS GAS MARKET DEMAND RULE TO RELIEVE VALERO OF ANY PAYMENT OBLIGATION IN EXCESS OF THAT EXPRESSLY DEFINED BY THE CONTRACT IS NOT INVALID, AS THE NATURAL GAS POLICY ACT DOES NOT PREEMPT THE TEXAS GAS MARKET DEMAND RULE AS APPLIED BY THIS COURT.

24. REPLY POINT OF ERROR: THE GAS MARKET DEMAND RULE AS APPLIED BY THE COURT DOES NOT VIOLATE THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION.

In its Motion, Lively makes two arguments it never before has alleged: that the Gas Market Demand Rule is preempted by the Natural Gas Policy Act, and that it violates the Commerce Clause. (Motion, pp. 20-28).

First, in its Appellant's Brief and Reply Brief Lively never *controverted* the validity of the Gas Market Demand Rule *per se,* or the Railroad Commission's jurisdiction over Lively and Valero. It cannot do so for the first time on rehearing. *See Gillen v. Diadrill, Inc.*, 624 S.W.2d 259, 264 (Tex. App. — Corpus Christi 1981, writ dism'd).

Moreover, its arguments are meritless. Lively cites *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board of Mississippi,* 106 S. Ct. 709 (1986). In *Transco,* however, the court discussed the application of a Mississippi state ratable take order to an *interstate* pipeline, not an intrastate pipeline like Valero. The Court noted in part that Transco's compliance with Mississippi's law "disturbs the uniformity of the *federal* scheme, since *interstate* pipelines would be forced to comply with *varied* state regulations of their purchasing practices." 106 S. Ct. at 712. Thus, *Transco* is wholly inapposite, which perhaps is why Lively never cited or based a point of error upon it in its appellate briefing.

Moreover, the order in *McGoldrick Oil Co. v. United Gas Pipe Line Co.*, C.A. No. H-84-4971 (September 17, 1987) is also inapposite. First, defendant United Gas is again an interstate pipeline.

Incredibly, Lively asserts that "no valid reason exists for distinguishing between interstate and intrastate pipelines. . . ." Lively therefore would welcome the inter-

ference of the Federal Energy Regulatory Commission in strictly intrastate dealings, when even the federal courts themselves have not gone this far. The logical extension of Lively's argument is that the Texas Railroad Commission, and the Texas statutes on conservation, are all entirely preempted by the federal regulatory scheme. It is not surprising that none of the cases Lively cites support this proposition.

Moreover, the *McGoldrick* court noted that "the Texas rule is relied on by United solely to free itself of a contractual obligation. . . ." Valero, however, is not relying on the Gas Market Demand Rule to unilaterally *free* Valero of a contractual obligation. Rather, in this case the Contract does not *impose* on Valero any obligation to pay for gas it cannot legally take.

Finally, no case holds, even by analogy, that the Gas Market Demand Rule violates the Commerce Clause.

The Motion presents no valid reasons for rehearing and should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing Valero Transmission Company's Response in Opposition to Appellants' Motion for Rehearing has been served on opposing counsel by certified mail, return receipt requested, on the 18th day of April, 1988.

By /s/ CARRIN F. PATMAN
Carrin F. Patman

NO. C-7676

IN THE
SUPREME COURT OF TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Petitioners

vs.

VALERO TRANSMISSION COMPANY,
Respondent

FROM NO. 04-87-00380-CV
IN THE COURT OF APPEALS FOR THE
FOURTH SUPREME JUDICIAL DISTRICT OF
TEXAS AT SAN ANTONIO,
BEXAR COUNTY, TEXAS

RESPONDENT'S REPLY TO APPLICATION FOR WRIT OF ERROR

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COMPLETE LIST OF THE PARTIES

A complete list of the names of all parties follows:

Petitioners:

Lively Exploration Company
Lea Roy Aldwell, Individually
Lea Roy Aldwell
Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased
Jon A. Sonnen
J. Howard Marshall
Ed Farrell
Elizabeth Standish
The Desana Corporation
Jessee L. Dally
Chester H. Kenley
Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased
H. B. Lively
B. Jackson Bandy
Robert L. Banks
Theo B. Bean
William R. Gifford
Charlie Gill, Jr.
Henry Gunders and wife, Elaine Gunders
Kenneth L. Hewitt
Kallman Nashner
Frank Pace, Jr.
Martin B. Seretean
Ray B. Vaughters
Theodore L. Wilkinson

Respondent:

Valero Transmission Company

NO. C-7676

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vs.

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BEXAR COUNTY, TEXAS

RESPONDENT'S REPLY TO APPLICATION FOR WRIT OF ERROR

To The Honorable Supreme Court of Texas:

Valero Transmission Company, successful appellee in Cause No. 04-87-00380-CV, in the Court of Appeals for the Fourth Supreme Judicial District of Texas at San Antonio, and defendant in the District Court, respectfully submits this Reply to the Application for Writ of Error of petitioners Lively Exploration Company, et al.

I. STATEMENT OF THE CASE

Petitioners Lively Exploration Company, et al. ("Lively") sued respondent Valero Transmission Company ("Valero") for breach of a gas purchase contract ("Contract") requiring Valero to take, or pay for if available, 90% of the quantity of gas Lively had "available for delivery," "not exceeding the maximum . . . rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas. . . ." (Contract, arts. V, I[j]). The jury found against Lively on its take-or-pay claim, and the trial court entered judgment in favor of Valero. The court of appeals affirmed the trial court's judgment. Lively has filed an Application for Writ of Error ("Application") with this Court.

The court of appeals' opinion correctly states the nature and results of the suit.

II. REPLY TO STATEMENT OF JURISDICTION

The Supreme Court has no jurisdiction to consider the Application because the holdings of the Court of Appeals to which Lively objects were correct holdings of substantive law.

III. REPLY POINTS OF ERROR

Reply Point of Error 1:

THE COURT OF APPEALS CORRECTLY HELD THAT THE TEXAS GAS MARKET DEMAND RULE APPLIES IN DETERMINING THE OBLIGATIONS OF VALERO UNDER THE TAKE-OR-PAY PROVISION OF THE CONTRACT. (Reply to Lively's Point of Error 1)

Reply Point of Error 2:

THE COURT OF APPEALS CORRECTLY HELD THAT THE GAS MARKET DEMAND RULE WAS RELEVANT AND MATERIAL TO PROVE OR DISPROVE THAT THERE WAS A BREACH OF THE TAKE-OR-PAY PROVISION OF THE CONTRACT. (Reply to Lively's Point of Error 2)

Reply Point of Error 3:

THE COURT OF APPEALS CORRECTLY HELD THAT THE INCLUSION OF THE TEXAS GAS MARKET DEMAND RULE IN THE CHARGE TO THE JURY WAS NOT HARMFUL ERROR. (Reply to Lively's Point of Error 3)

Reply Point of Error 4:

THE COURT OF APPEALS CORRECTLY HELD THAT THE OBLIGATIONS OF VALERO UNDER THE TAKE-OR-PAY PROVISION OF THE CONTRACT ARE CONTROLLED BY THE DEFINITIONS OF "DAILY CONTRACT QUANTITY" AND "DELIVERABILITY" SET FORTH IN ARTICLE I OF THE CONTRACT. (Reply to Lively's Point of Error 4)

Reply Point of Error 5:

THE COURT OF APPEALS CORRECTLY HELD THAT THE TRIAL COURT PROPERLY SUBMITTED TO THE JURY SPECIAL ISSUE NO. 2 AND INSTRUCTION NO. 2 CONTAINING THE DEFINITION OF "DELIVERABILITY" FROM ARTICLE I(j) OF THE CONTRACT. (Reply to Lively's Point of Error 5)

Reply Point of Error 6:

THE COURT OF APPEALS CORRECTLY HELD THAT LIVELY WAIVED ITS OBJECTION TO SPE-

CIAL ISSUE NO. 2 AND INSTRUCTION NO. 2 CONTAINING THE DEFINITION OF "DELIVERABILITY" FROM ARTICLE I(j) OF THE CONTRACT. (Reply to Lively's Point of Error 6)

Reply Point of Error 7:

THE COURT OF APPEALS CORRECTLY HELD THAT THE INSTRUCTIONS TO SPECIAL ISSUE NO. 2 WERE RELEVANT, WERE NOT A COMMENT ON THE WEIGHT OF THE EVIDENCE, AND DID NOT CAUSE A RENDITION OF AN IMPROPER JUDGMENT. (Reply to Lively's Point of Error 7)

Reply Point of Error 8:

THE COURT OF APPEALS CORRECTLY HELD THAT THE TRIAL COURT FAIRLY SUBMITTED SPECIAL ISSUE NO. 2 AND CONDITIONALLY SUBMITTED SPECIAL ISSUE NO. 3 (Reply to Lively's Point of Error 8)

Reply Point of Error 9:

THE COURT OF APPEALS CORRECTLY HELD THAT LIVELY CONCEDED THAT THE EVIDENCE OF THE GAS MARKET DEMAND RULE SUPPORTED THE JURY FINDING AND SPECIAL ISSUE NO. 2. (Reply to Lively's Point of Error 9)

Reply Point of Error 10:

THE COURT OF APPEALS CORRECTLY HELD THAT THERE WAS EVIDENCE TO SUPPORT THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY. (Reply to Lively's Point of Error 10)

Reply Point of Error 11:

THE COURT OF APPEALS CORRECTLY HELD THAT LEGALLY CORRECT EVIDENCE SUPPORTS THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY. (Reply to Lively's Point of Error 11)

Reply Point of Error 12:

THE COURT OF APPEALS' ACTION IN APPLYING THE TEXAS GAS MARKET DEMAND RULE TO RELIEVE VALERO OF ANY PAYMENT OBLIGATION IN EXCESS OF THAT EXPRESSLY DEFINED BY THE CONTRACT IS NOT INVALID, AS THE NATURAL GAS POLICY ACT DOES NOT PREEMPT THE TEXAS GAS MARKET DEMAND RULE AS APPLIED BY THIS COURT. (Reply to Lively's Point of Error 12)

Reply Point of Error 13:

THE GAS MARKET DEMAND RULE AS APPLIED BY THE COURT OF APPEALS DOES NOT VIOLATE THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION. (Reply to Lively's Point of Error 13)

IV. STATEMENT OF FACTS PERTINENT TO ALL REPLY POINTS OF ERROR.

A. *The Parties.*

Valero is a public utility intrastate gas pipeline company that purchases, transports, and sells natural gas throughout the State of Texas. Valero operates over 7,000 miles of pipeline connected to over 13,000 wells.

(S.F. 542, 677.) Valero's customers include gas distribution companies that service cities such as San Antonio, Austin, and Dallas, industrial consumers, and other pipeline companies. (S.F. 529-30.)

Lively is comprised of producers, operators, royalty interest owners, and sellers of oil and gas in Texas. (S.F. 105-07). Valero and Lively agree that they are at all times subject to the regulatory authority of the Railroad Commission of Texas ("Commission"). Tex. Rev. Civ. Stat. arts. 6050-53 (Vernon 1962 and Vernon Supp. 1987); Tex. Nat. Res. Code Ann. Sec. 81.051, 111.081 (Vernon 1978). (S.F. 419-23; 675, 1552, 1556.)

B. *The Contract.*

On February 12, 1973, Lively and Valero's predecessor-in-interest entered into the Contract (P. Ex. 1) for the sale of natural gas produced from Lively's properties in Sutton County, Texas. At the time Lively and Valero entered into the Contract, demand for natural gas far outstripped supply, and Lively and Valero both concede that neither foresaw the eventual dramatic oversupply that has changed the entire nature of the natural gas industry. (S.F. 147-48, 593-94.)

Lively and Valero included various provisions in the Contract relevant to this lawsuit. Among these provisions is a "take-or-pay" provision:

> *Subject to the other provisions hereof,* Buyer agrees to purchase and pay for (or, *if Buyer's performance hereunder is not excused by other provisions of this agreement,* pay for, *if available,* whether taken or not) during the days of each Contract year . . . a *Daily Contract Quantity* of gas from Seller's Lands

> and Leases in the Contract Area equal to ninety percent (90%) of Seller's daily *Deliverability* of gas hereunder.

(P. Ex. 1, p. 12, Art V, § 5.3) (emphasis supplied).

The take-or-pay provision references two specific terms that are defined in the Contract and operate with the take-or-pay clause to set forth Valero's take-or-pay obligations: "Daily Contract Quantity" ("DCQ") and "Deliverability." The Contract defines "DCQ" as "the quantity of gas per day, averaged over each contract year, which Buyer is required to take from Seller hereunder at the point of delivery specified in this Agreement." (P. Ex. 1, p. 2, art. I[e].)

Since the Contract states that the DCQ is 90% of *Deliverability*, the extent of any take-or-pay obligation must be measured in accordance with the specific Contract definition of "Deliverability":

> [T]hat quantity of gas which Seller *has available for delivery* from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but *not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction*. Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects

> to take hereunder up to the maximum quantity in accordance with good engineering and gas production practice can be produced from Seller's wells in the field.

(P. Ex. 1, p. 3, art. I [j]) (emphasis supplied.)[1]

Thus, the Contract's take-or-pay provision requires Valero to take, or pay for *if available*, 90% of the quantity of gas Lively has *available for delivery, not to exceed* the maximum production allowed by the Commission.

The take-or-pay provision was included to reassure Lively that Valero would not discriminate against Lively by taking gas from a producer with a lower price to the exclusion of Lively, whose gas in the subject area was dedicated to the Contract.

The Contract also includes a "regulatory bodies" clause expressly making the Contract *subject to* Texas laws and the rules and regulations of an "authority having jurisdiction" such as the Commission:

> This Agreement is made *subject to* all valid applicable federal and state laws or city ordinances, and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction.

(P. Ex. 1, p. 27, art. XIII, § 13.1.)

Additionally, the parties included a *force majeure* clause, specifying failure of markets as an event of ***force majeure:***

---

1. Although in its Application for Writ of Error, Lively argues that the Contract also contains another definition of "Deliverability," throughout trial the definition in art. I(j) was accepted as the proper one by *both sides*. Lively in fact submitted *only the definition* in art. I(j) of "Deliverability" as an instruction in its proposed charge.

> If either party hereto is rendered unable, wholly or in part, by force majeure, or other causes herein specified, to carry out its obligations under this Agreement, other than any matured obligation to pay money, it is agreed that upon notice . . . then the obligations of the party giving such notice, so far as they are affected by such force majeure or other causes herein specified, shall be suspended during the continuance of any inability so caused. . . .
>
> * * *
>
> The term "force majeure" as employed herein includes without limitation by the following enumeration acts of God . . . *temporary failure of wells or sources of supply of gas, or market;* and any other causes, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming suspension and which by the exercise of due diligence such party is unable, wholly or in part, to prevent or overcome. . . .

(P. Ex. 1, pp. 26-26A, art. XII, §§ 12.1,12.2.)

C. - *Relevant Laws and Regulations.*

1. *The Regulated Nature of the Texas Oil and Gas Industry.*

The repeated deference in Contract provisions to Texas laws and Commission rules and regulations reflects the parties' recognition that the Commission regulates basically all facets of the drilling, production, transportation, and use of natural gas in Texas. (S.F. 419-23, 1474.)

The Commission's authority is accorded by the Texas Natural Resources Code ("Code"). The Code declares "waste" to be unlawful, and defines "waste" as *"the production of natural gas in excess of* transportation or

market facilities, or *reasonable market demand* for the type of gas produced." Tex. Nat. Res. Code Ann. § 86.001-.012 (Vernon 1978) (emphasis supplied) (S.F. 1491). The Code charges the Commission with adopting "all necessary rules" to ensure production of natural gas in accordance with market demand and to prevent its *waste*. Code §§ 85.051, 85.052, 86.001, *et seq.*, 111.081, *et seq.* (Vernon 1978 and Vernon Supp. 1987) (emphasis supplied.)

The Commission also implements the Code's goal of "compelling *ratable* production," Code § 86.001, and carries out the Texas Common Purchaser Act's stipulation that a pipeline such as Valero must purchase gas without discrimination in favor of one producer or person against another producer or person in the same field and without unjust or unreasonable discrimination between fields in Texas. Code § 111.083 and § 111.086.

2. *The Gas Market Demand Rule Adopted in 1978.*

To discharge its Code-prescribed duties of conserving Texas' precious natural gas in an equitable manner, in 1978 the Commission adopted a system to "prorate" natural gas production — i.e., to determine the overall quantity of natural gas that should be produced in Texas in a given month and to assure that each producer is allowed to produce his fair share of that amount. (S.F. 1551.) The heart of this system, and one of the primary regulations with which Valero and Lively are required to comply, is known as the Gas Market Demand Rule. 16 Tex. Admin. Code § 3.91 ("§ 3.91") (prior to 9/1/86) and 16 Tex. Admin. Code § 3.30 ("§ 3.30") and § 3.34 ("§ 3.34") (from and after 9/1/86, as

amended effective 3/2/87) ("Gas Market Demand Rule" or "Rule"). (D. Ex. 7; S.F. 1491-94.)[2]

Both Valero and Lively *agree* on what the Gas Market Demand Rule says and requires. At trial, Valero presented uncontroverted testimony by John Poerner ("Poerner"), a Railroad Commissioner when the Gas Market Demand Rule was adopted and subsequently chairman of the Commission, who thoroughly explained the Rule and its operation. (S.F. 1472-1556.)

As Poerner elucidated, and as Lively concedes, the Rule's gravamen is two-fold. First, it requires an intrastate pipeline company such as Valero: (i) *to limit its purchases* of gas from producers to proportionate shares of the pipeline's downstream market demand; (ii) *to allocate its purchases* "ratably" (without discrimination) among its various producers; and (iii) to purchase various categories of gas, established by the Commission, in a specified order of priority. 16 Tex. Admin. Code § 3.91 (prior to 9/1/86); (D. Ex. 7, 21; S.F. 324-25, 689, 693, 910, 989, 1007, 1050, 1494).

Second, it proscribes a *producer* such as Lively from producing gas in excess of its ratable share of its purchaser's downstream market demand. (S.F. 935, 989, 1050, 1552, 1556.) The achievement of ratability *requires* participation by the producers, since producers, not pipelines, have physical control of the wells and the quantity of gas actually produced. (S.F. 715, 1344.)

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2. The Gas Market Demand Rule as issued on January 16, 1978 was introduced into evidence as D. Ex. 7. Lively objected to evidence of amendments after the Contract years at issue, and the trial court excluded such evidence. Thus, all citations to sections of the Gas Market Demand Rule are to the sections as in effect during the Contract years at issue, and as reflected in D. Ex. 7.

To ensure that production and takes are in accordance with market demand, the Gas Market Demand Rule explicitly sets forth steps that producers and pipelines must follow each month. To summarize, early each month a pipeline's downstream customers give the pipelines "nominations" of their "firm forecast of . . . [their] actual demand." (D. Ex. 7, § .001(d) (2) (A); S.F. 683-84.) The pipeline then files its own nomination with the Commission reflecting the amount of gas it expects to take from each field. (S.F. 1318-19.) The pipeline must nominate an amount *equal to* the total quantity for which it is the ultimate consumer and the total quantity nominated by its downstream purchasers. (D. Ex. 7, § .001(d); S.F. 682-84.) In making its nominations, a pipeline must "ratably apportion" them from the fields from which it purchases and from the gas wells connected to its system. (D. Ex. 7, § .001(e).) A pipeline must also make its nominations according to the Commission's "priority system" of different categories of gas. *Id.* The priority system requires a pipeline to nominate, take, and exhaust all of a higher category of gas available from its producers before taking any gas in a lower category. (*Id.*, D. Ex. 20; S.F. 693, 1324-25.)[3]

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3. Specifically, under the 1978 Gas Market Demand Rule "casinghead gas" was given the highest priority, followed by gas classified as "Rule 49(b)" gas as second priority, and "special allowable" gas as third priority. (S.F. 591, 622, 689, 1494.) Valero must purchase all *priority gas* ("casinghead," then "Rule 49(b)," and then "special allowable" gas) dedicated to its system before it can purchase *any non-priority* gas (such as the prorated "gas well gas" produced by Lively). (S.F. 693.) The Commission established the priority categories based on sound public policy considerations. For example, in according casinghead gas highest priority the Commission was mindful of the Arab oil embargo, since curtailment of casinghead gas interrupts oil production. (S.F. 1494.)

The pipeline then tells its producers the amount it intends to nominate, so that they can forecast production. (S.F. 685-86, 1321.) The Commission adds up nominations of all pipelines taking gas from a given field, divides that number among the wells in a field and allocates an amount of production to each particular well. (S.F. 1499-1500.) This amount is the well's "full prorated allowable." (S.F. 1336, 1500.)

Because actual market demand may deviate from the amount projected by a pipeline in its nomination, each month a pipeline gives each of its producers a "rate of flow request" letting it know the pipeline's actual market demand, and how much gas the producer should tender to supply its ratable share of that market demand. (S.F. 686-87.) If the pipeline's demand is less than projected in its nomination, production from each well *must* be reduced ratably (proportionately), even though the well's "allowable" may be set at a higher amount. (S.F. 687.) Based on the procedures outlined in the Gas Market Demand Rule a pipeline then purchases gas without discrimination and in accordance with the priority categories. (S.F. 934.)

In summary, the overriding goal of Texas' complex and carefully drawn regulatory scheme governing the oil and gas industry is to ensure that production of natural gas does not exceed market demand and result in "waste" as that term is defined by statute, and that production of the market demand is fairly apportioned among producers. (S.F. 1491-93, 1499, 1551.)

D. *The Interface Between the Gas Market Demand Rule and the Contract.*

Pursuant to the *parties' own agreement* as reflected

throughout the Contract, the take-or-pay provision and Gas Market Demand Rule work in tandem to define Valero's take-or-pay obligations. Both Valero's obligation to take and its alternative obligation to pay are limited *by the Contract's own terms* to the quantity Lively has "available for delivery," "not exceeding the maximum rate of flow permitted by [Commission rules and regulations]." The Gas Market Demand Rule therefore governs the amount of gas Lively can have "available for delivery" at a given time, and establishes that the "maximum . . . rate of flow" under the Contract can never exceed Valero's downstream market demand.[4]

It is *uncontroverted* that Valero's downstream market demand has drastically declined. (S.F. 568, 571, 1040, 1483-84, 1532; D. Ex. 11A, 38, 64.) It was similarly undisputed at trial (and Petitioners have not argued otherwise in their Application or before the court of appeals) that *during the Contract years in issue Valero nominated and requested all of Lively's gas for which Valero had a downstream market demand.* (S.F. 1349-51, 1376.)[5]

Any quantity exceeding the amount Valero actually took from Lively, therefore, could not be produced pursuant to Commission rules. Thus, the Contract by its own terms did not require Valero either to take or to pay for that amount of gas.

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4. It is worth noting that the Gas Market Demand Rule also established procedures preventing the discrimination the take-or-pay clause was originally included to discourage.

5. Although in its Application Lively vaguely accuses Valero of "manipulation" of its nominations and requests, at trial Lively in fact offered *no evidence* whatsoever of any improper "manipulation". In truth, the evidence at trial was uncontroverted that Valero nominated and requested all of Lively's gas for which it had a downstream market demand, and complied fully with Texas laws and Commission rules.

E. *Lively's Lawsuit.*

Despite the fact that Valero had clearly complied with the Contract's take-or-pay provisions, Lively sued Valero for purportedly breaching the take-or-pay clause for the Contract years 1982-1985. Valero therefore found itself in the ironic position of *defending* a breach of contract lawsuit despite its compliance with the plain terms of the Contract.

F. *The Trial.*

At trial, Lively called only three witnesses: Harry Lively, who testified about the Contract although he had not negotiated it (S.F. 149-50); Jimmy Condra, who testified as to the results of alleged "deliverability tests" on the wells even though he had not run the tests himself in the last five years (S.F. 660-61) and even though the pumper he claimed had run the tests testified that he had never run such tests (S.F. 952-53); and Max Powell, who testified as to alleged take-or-pay damages. (S.F. 367-403.)

Valero called a number of witnesses, including: John Poerner, who testified concerning the meaning and import of the Gas Market Demand Rule (S.F. 1447-1552); Frank J. Becraft, President of Valero, and Jeffrey H. Parish, Director of Proration and Producer Affairs of Valero, who testified as to the decline in Valero's downstream market and Valero's strict adherence to the Gas Market Demand Rule (S.F. 531-34, 565-73, 710, 713, 675-936, 1307-76); Travis B. Crow, Valero's Director of Reserve Evaluation, who testified about the unreliability of Lively's "deliverability" tests (S.F. 1191-1271); Dr. Alan Anderson, who testified about the

decline in Valero's downstream market (S.F. 982-1051); and several others. Most of Valero's evidence was uncontroverted.

The take-or-pay claims were submitted to the jury. In response to Special Issue No. 2, the jury answered "no" to the question, "Do you find that Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity ("DCQ")?" (Tr. 145.) Thus, the trial court properly entered a take-nothing judgment against Lively on its take-or-pay claim against Valero. (Tr. 158).

G. *The Appeal.*

Lively appealed the judgment as to its take-or-pay claim. The court of appeals completely affirmed the trial court's judgment. Lively has appealed to this Court.

In its Application, Lively recognizes that it cannot undermine the jury's verdict or the trial court's judgment based on the Record or the applicable law. Therefore, in its Application Lively distorts the plain meaning of some Contract provisions and omits reference to others, mischaracterizes Valero's position, and ignores the overwhelming evidence supporting the jury's findings, most of which Lively did not even attempt to controvert at trial. Lively even complains on appeal of an instruction to the jury that *Lively* submitted.

That Lively cannot rely on the Record as it exists and the Contract as it is written confirms that an accurate characterization of the Contracts, the law, and the evidence compels denial of the Application.

V. THE RELEVANCE OF THE GAS MARKET DEMAND RULE

Reply Points of Error 1-4 In Summary:

THE COURT OF APPEALS CORRECTLY HELD THAT THE CONTRACT LIMITS VALERO'S PAYMENT OBLIGATION TO AN AMOUNT THAT CAN BE LEGALLY DELIVERED.

A. *The Overall Fallacy in Lively's Argument.*

Lively's argument under its First through Fourth Points of Error embodies a complete mischaracterization of Valero's position. Lively erroneously asserts that Valero relies on the Gas Market Demand Rule as unilaterally abrogating otherwise existing contractual obligations:

> Valero seeks to avoid its obligations under [the take-or-pay] provision by asserting that the Railroad Commission Gas Market Demand Rule *abrogates* the take-or-pay provision by limiting Valero's obligation to take gas to its market demand and consequently relieves Valero of its obligation to pay for the Daily Contract Quantity of gas not taken. It is Petitioners' position that as a matter of law the Gas Market Demand Rule does not affect the rights and obligations of the parties to this contract by relieving Valero of its obligation to pay for the minimum quantity of gas provided by the Contract.

(Application, p. 13) (emphasis supplied.)

This is not Valero's position at all, and by making such an argument, Lively is merely assailing a "straw man." Whether the Gas Market Demand Rule unilaterally *abrogates* the take-or-pay provision is ***not the issue*** in

this appeal. Rather, the issue is the interpretation of *this* Contract, in which the *quantity* of gas Valero is required to take *or pay for* is *defined* as an amount "available for delivery," "not exceeding the maximum . . . rate of flow permitted by [Commission] rules." (P. Ex. 1, p. 3, art. I[j].)

As explained in § IIIB, *supra*, the take-or-pay provision requires Valero to take or pay for 90% of Seller's daily Deliverability. Deliverability is defined in the Contract as the "quantity of gas which Seller has *available for delivery . . . but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.*" Thus, the *Contract* itself states that Commission rules and regulations can limit Valero's obligation to take *and* its alternative obligation to pay. The Contract does not require Valero's *payment* for a minimum quantity of gas as measured in Mcfs or Btus; it requires payment for a certain *percentage* of "Deliverability," a defined term that embodies the concept that it is limited by Commission rules and regulations.

Lively's entire argument under its First through Fourth Points of Error, the bulk of its Application, is therefore based on a faulty premise, and ignores the plain words of this Contract. In essence, through its lawsuit Lively sought to ***rewrite*** and engraft into the Contract a provision the parties did not include.

Lively seeks to capture this Court's attention by claiming, in italics:

> **This is the first time a Texas court has made such a holding** [that the Gas Market Demand Rule unilat-

Id. at 423. The Court thus recognized the validity of take-or-pay provisions of gas contracts where pipelines are committed to purchase gas in excess of market demand.

Following the Supreme Court's holding in *Transco,* the United States District Court, Southern District of Texas, Houston Division, in *McGoldrick Oil Company, et al v. United Gas Pipe Line Company,* Civil Action No. H-84-4971, by order of September 17, 1987, held:[14]

> The Texas Gas Market Demand Rule, governing ratable production, is preempted under *Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi,* ____U.S.____, 106 S. Ct. 709 (1986). Although states may regulate the production of natural resources in order to achieve a statewide public benefit, such as conservation, *the Texas rule is relied on by United solely to free itself of a contractual obligation. If the rule were enforced to free pipelines of their obligations under take-or-pay contracts, its effect would be contrary to the public interest sought to be served by the federal regulation: gas prices would remain high in spite of an oversupply.*

In a Memorandum on Denial of Modification of the above order,[15] that Court stated as follows:

> United Gas Pipe Line's motion to modify the order of September 17, 1987, will be denied. The September order modified an earlier June memorandum, making is consistent with Transcontinental Gas Pipe Line Corporation v. State Oil and Gas Board of Mississippi, ____U.S.____, 106 S. Ct. 709 (1986).

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14. Appendix at A55.

15. Appendix at A58.

Had United wanted to limit its takes of gas under its contract with McGoldrick during periods when gas was in surplus supply, it could have negotiated a market out clause. The contract was drafted by sophisticated attorneys for clients with substantial experience in gas production and marketing. *Allegations that United in good faith believed that the contract's incorporation of the Texas Gas Market Demand Rule was to work as a substitute for a market out clause which could be invoked when the price and demand for gas dropped are disingenuous.* United signed a contract for mandatory minimum purchases of gas during a time of inflated gas prices, gambling that the economy would remain favorable to suppliers. Even if United lacked the capacity immediately to take and resell McGoldrick's gas, it was not commercially impracticable for United to pay for the gas, as it was contractually obligated to do.

The court's September order did not invalidate the Texas ratable production scheme. As Transco has instructed, the statute remains enforceable to achieve certain state goals such as preservation of resources, protection of correlative rights, and waste prevention. Congress' intent to move toward a less-regulated national gas market cannot be interpreted as an invitation to the states to impose additional regulations. Transco at 717. The Texas Gas Market Demand Rule, as applied to purchasers such as United, is preempted, 106 S. Ct. at 718.

In *ANR Pipeline Co. v. Corporation Commission of Oklahoma,* 643 F.Supp. 419 (W.D. Okla. 1986), the Court held the Oklahoma statute and the Oklahoma Corporation Commission Rule 1-305 to be "*unconstitutional as applied to the plaintiffs*" in that case. *Id.* at 424. That statute and rule, like the Texas Gas Market Demand

Rule, provides for ratable purchases of gas by pipelines from a common source of supply on a systemwide basis and establishes a priority schedule for the purchase of gas when production exceeds that purchaser's market demand.

In *Schneidelwind v. ANR Pipeline Co.,* 56 U.S.L.W. 4249 (March 22, 1988), the United States Supreme Court held that a Michigan statute "regulates in a field the NGA has occupied to the exclusion of state law, and that it is therefore preempted." *Id.* at 4251. The statute required a public utility exercising or claiming the right to transport natural gas for public use to obtain approval from the Michigan Public Service Commission before issuing long term securities. Referring to the "comprehensive scheme of federal regulation" in the Natural Gas Act, the Court stated that "while the NGA does not expressly grant FERC preissuance authority over the securities of natural gas companies, FERC achieves the regulatory ends of such review with regard to rates and facilities through the exercise of its express regulatory responsibilities." *Id.* at 4254. In view of its conclusion that the Michigan statute "is pre-empted by the NGA," the Court stated that "we need not decide whether, absent federal occupation of the field, Act 144 violates the Commerce Clause. *See Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Bd. of Mississippi,* 474 U.S. 409, 425 (1986)." *Id.* at 4254.

As recognized in *Transco,* the NGPA resulted in "unification of the interstate and intrastate markets," and now there is a "national natural gas market." 474 U.S. at 423-424. That this is the case is further evidenced by the fact that Section 105 of the NGPA covers "sales under existing *intrastate* contracts."

The authority given by the NGPA to FERC to regulate the price of "all first sales of natural gas irrespective of its interstate or intrastate character" was upheld in *State of Oklahoma v. Federal Energy Regulatory Commission,* 661 F.2d 832 (10th Cir. 1981), *cert. denied,* 457 U.S. 1105 (1982). The Court there held that "the enactment of the NGPA is a constitutionally acceptable exercise of Congress' Commerce Clause power." 661 F.2d at 838. The basis of the Court's holding, among other things, was that Congress may regulate wholly intrastate activities which have "a substantial economic effect on interstate commerce or when the intrastate activity is necessary to effectuate the interstate regulation"; "Congress had a rational basis for determining that the unregulated intrastate market imposed a burden on interstate commerce"; and "Congress may preempt state conservation regulations which interfere with or burden interstate commerce." *Id.* at 834-835.

In considering the validity of state ratable take rules such as the Texas Gas Market Demand Rule, there is no longer any valid reason for differentiating between interstate and intrastate pipelines. Both pipelines purchase from the same producers, the same fields, and even the same wells, and the maximum price of the first sales to them is regulated by FERC irrespective of the destination of the gas. Therefore, the Texas Gas Market Demand Rule as applied by the Court of Appeals is not only pre-empted by the NGPA but also runs afoul of and violates the Commerce Clause of the United States Constitution.

Even if, as Valero contends, the definition of "Deliverability" in Article I(j) of the contract can be construed

as limiting Valero's takes of gas to its market demand under the Gas Market Demand Rule, that portion of the agreement would be unenforceable here since during the Contract Years in question the Gas Market Demand Rule as so applied by the Court of Appeals is pre-empted by the NGPA and violates the Commerce Clause. "Parties, by contract, cannot impair the validity of a law, nor control or limit the provisions of a statute." *McFarland v. Haby,* 589 S.W.2d 521, 524 (Tex. Civ. App.—Austin 1979, writ ref'd n.r.e.); *Gorman v. Gause,* 565 S.W.2d 855 (Tex. Comm'n App. 1933, judgmt adopted).

The Gas Market Demand Rule need not be, and was not intended by the Railroad Commission to be, applied in the manner applied by Valero and the Court of Appeals. The proper application of that rule, by holding that it does not relieve a gas purchaser of its alternative obligation under the take-or-pay provision of a gas contract to pay for the minimum quantity of gas it agreed to take, not only is in accord with the Railroad Commission's intention in promulgating the rule but also avoids the rule being pre-empted by the NGPA and being violative of the Commerce Clause of the United States Constitution.

CONCLUSION

The Court of Appeals clearly erred in the respects set forth in the above Points of Error. For the reasons stated, the Supreme Court of Texas should grant the application for writ of error and reverse the judgment of the Court of Appeals and of the Trial Court and take other action as requested in the Prayer for Relief.

PRAYER FOR RELIEF

Petitioners respectfully request that this Court reverse the judgment of the Court of Appeals for the Fourth Supreme Judicial District of Texas and of the Trial Court that Lively take nothing by way of their take-or-pay cause of action, render judgment that Valero is liable to Lively for its failure to pay for the Daily Contract Quantity under the contract for the Contract Years 1982, 1983, 1984, and 1985, remand the case for a new trial as to the amount owed to Lively by Valero, in all other respects affirm the Trial Court's judgment, and grant Petitioners Lively such other and further relief to which they may be justly entitled, including the taxing of the costs to the Respondent.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that Petitioners' Application for Writ of Error was served on the Respondent by mailing a true copy to its attorney by certified mail, return receipt requested, by depositing it, postpaid, in an official depository under the care and custody of the United States Postal Service on the 15th day of June, 1988, enclosed in a wrapper addressed as follows:

J. Clifford Gunter, III
Bracewell & Patterson
2900 South Tower Pennzoil Place
Houston, Texas 77002

/s/ JESSE P. LUTON, JR.
Jesse P. Luton, Jr.

No. C-7676

IN THE
SUPREME COURT OF TEXAS
AUSTIN, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Petitioners,

v.

VALERO TRANSMISSION COMPANY,
Respondent.

MOTION FOR REHEARING

To The Honorable Supreme Court Of Texas:

Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley, Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H.B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters, and Theodore L. Wilkinson (collectively referred to as "Lively" or "Petitioners"), Petitioners in this cause, make this Motion for Rehearing, and in support thereof show:

I.

On the 7th day of June, 1989, this Court denied Petitioners' Application for Writ of Error in this cause.

II.

This Court erred in not granting the Application for Writ of Error upon Points of Error 1 and 2, which read:

> POINT 1. The Court of Appeals erred in holding that the Texas Gas Market Demand Rule applies in determining the obligations of Valero under the take-or-pay provision of the contract.
>
> POINT 2. The Court of Appeals erred in holding that the Texas Gas Market Demand Rule was relevant and material to prove or disprove that there was a breach of the "take-or-pay" provision of the contract as alleged by Lively.

The Court of Appeals held that the Gas Market Demand Rule applies so as to relieve Valero Transmission Company ("Valero") of its obligations under the "take-or-pay" provision of the natural gas contract. *Lively Exploration Co. v. Valero Transmission Co.*, 751 S.W.2d 649 (Tex. App.—San Antonio 1988, writ denied). The court based its opinion upon the provisions of the contract, including Article XIII, paragraph 13.1, making the agreement "subject to all valid applicable federal and state laws or city ordinances, and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction." *Id.* at 656.

The above-quoted government regulation clause is a standard provision in natural gas contracts. However, even if this provision were not in the contract, these laws and regulations would become a part of the contract

and govern the transaction. *Wesseley Energy Corp. v. Jennings,* 736 S.W.2d 624 (Tex. 1987); *Langever v. Miller,* 124 Tex. 80, 76 S.W.2d 1025 (1934).

Therefore, the effect of the Court of Appeals' reliance upon the government regulation clause is to hold that the Gas Market Demand Rule relieves *all* pipeline purchasers in Texas of their take-or-pay obligations under *all* of their natural gas contracts in the absence of an express provision to the contrary. This application of the Gas Market Demand Rule is contrary to the clear intention of the Texas Railroad Commission in promulgating that rule and to many rulings of courts in Texas and other states that contractual obligations to pay for gas are not superseded or abrogated by the Gas Market Demand Rule.[1]

This is the first time a Texas court has made such a holding, and its ramifications are far reaching and will have a serious adverse effect on gas producers in this state.

Since the Court of Appeals' opinion, Valero and other natural gas pipeline purchasers have sought to apply that opinion in the manner set forth above so as to relieve them of any obligations under take-or-pay provisions in their gas purchase contracts. This is shown by Exhibit A, pp. 37-38, to the Response of Amici Curiae Cardwell & Hart to Respondent's Reply filed in this Court, in which Valero argued in another case that the Court of Appeals' opinion in this case "conclusively validates" the defense that the Gas Market Demand Rule "obviates" the take-or-pay obligations in gas purchase contracts.

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1. *See* Application for Writ of Error, pp. 14-24.

Therefore, the opinion of the Court of Appeals and this Court's denial of Petitioners' Application for Writ of Error already have resulted, and will continue to result, in reliance by pipeline companies on the Texas Gas Market Demand Rule as a complete defense to liability under take-or-pay provisions of natural gas contracts.[2]

As shown by the cases discussed in the Application for Writ of Error (pp. 17-24) and in the several amicus curiae briefs filed in support of the application, the trial court and the Court of Appeals erred in failing to hold *as a matter of law* that Valero is not relieved of liability under the take-or-pay provision of this contract by the application of the Gas Market Demand Rule. This Court's denial of the Application for Writ of Error effectively affirms that error and changes or so confuses the law in this state as to leave in doubt the validity of virtually every take-or-pay claim by producers against pipelines under natural gas contracts in this state.

This issue is far too important and involves far too many claims under natural gas contracts totaling hundreds of millions of dollars to leave the situation in the

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2. In the San Antonio Express-News, June 9, 1989, at 2-B, col. 1, Valero is reported as saying that the "appellate court's decision upheld Valero's defense that compliance with the market demand and ratable take rules of the Texas Railroad Commission can eliminate liability under the take-or-pay provisions contained in many intrastate gas purchase contracts." Bill Greehey, Chairman and Chief Executive Officer of Valero Energy Corp., is quoted in that same article as saying that "the action of the Texas Supreme Court in upholding our defenses in the Lively case will help us to bring about successful resolution of the few take-or-pay claims which remain outstanding." That article also states that Greg Wright, a Valero spokesman, "said about $60 million in take-or-pay claims are still pending against Valero."

clouded condition it now is in as a result of the Court of Appeals opinion and this Court's denial of the Application for Writ of Error with the notation, Writ Denied.

III.

The Court erred in not granting the Application for Writ of Error upon Points of Error 12 and 13, which read:

> POINT 12. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals is pre-empted by the Natural Gas Policy Act.
>
> POINT 13. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals violates the Commerce Clause of the United States Constitution.

The Gas Market Demand Rule (D. Ex. 7) requires pipeline companies to limit their purchases of gas from producers to each pipeline company's downstream market demand and to "ratably apportion" its purchases "so that takes from various gas producing properties shall be made without discrimination" among producers in the same field "and without unjust or unreasonable discrimination as between fields." (S.F. IX, 1516-1518). The Gas Market Demand Rule does not distinguish between interstate and intrastate pipeline companies.

The Court of Appeals applied the Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations

and liability under its contract with Lively. The Gas Market Demand Rule as applied by that court is preempted by the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301, *et. seq.*, and violates the Commerce Clause of the United States Constitution, U.S. Const. art. I, § 8, cl. 3. *See Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409 (1986) ("*Transco*"), and *ANR Pipeline Co. v. Corporation Commission of the State of Oklahoma*, 860 F.2d 1571 (10th Cir. 1988), *cert. denied*, 57 U.S.L.W. 3719 (U.S. May 2, 1989) (No. 88-1482). *See also Schneidewind v. ANR Pipeline Co.*, 485 U.S. ___, 99 L.Ed.2d 316 (1988).

In 1978, Congress passed the NGPA, which "has been justly described as 'a comprehensive statute to govern future, natural gas regulation.' Note, Legislative History of the Natural Gas Policy Act, 59 Texas L. Rev. 101, 116 (1980)." *Public Service Commission of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 332 (1983). As stated in the Texas Law Review note from which the United States Supreme Court quoted in the above case: "Congress also recognized the need to eliminate the distinction between the interstate and intrastate markets. Because the regulation-free intrastate market had imposed an opportunity cost on the interstate supply, Congress imposed price controls on intrastate gas in sections 105 and 106(b)." 59 Tex. L. Rev. at 120.

The authority given by the NGPA to FERC to regulate the price of "all first sales of natural gas irrespective of its interstate or intrastate character" was upheld in *State of Oklahoma v. Federal Energy Regulatory Com-*

mission, 661 F.2d 832 (10th Cir. 1981), *cert. denied*, 457 U.S. 1105 (1982). The Court there held that "the enactment of the NGPA is a constitutionally acceptable exercise of Congress' Commerce Clause power." 661 F.2d at 838. The basis of the Court's holding, among other things, was that Congress may regulate wholly intrastate activities which have "a substantial economic effect on interstate commerce or when the intrastate activity is necessary to effectuate the interstate regulation"; "Congress had a rational basis for determining that the unregulated intrastate market imposed a burden on interstate commerce"; and "Congress may pre-empt state conservation regulations which interfere with or burden interstate commerce." *Id.* at 834-835.

A Mississippi ratable-take rule requiring, like the Texas Gas Market Demand Rule, that pipelines purchase gas without discrimination in favor of one producer against another in the same source of supply was held to be preempted by the NGPA in *Transcontinental Gas Pine Line Corp. v. State Oil and Gas Board of Mississippi, supra.* There, the Court stated:

> [T]he NGPA reflects a congressional belief that a new system of natural gas pricing was needed to balance supply and demand. See S Rep. No. 95-436, at 10. The new federal role is to "overse[e] a *national market price regulatory scheme.*" Haase, 16 Houston L. Rev, at 1079; see S Rep No. 95-436, at 21 (NGPA implements "a new commodity value pricing approach"). The NGPA therefore does not constitute a federal retreat from a comprehensive gas policy. Indeed, *the NGPA in some respects expanded federal control, since it granted FERC jurisdiction over the intrastate market for the first*

IX. THE OVERWHELMING EVIDENTIARY SUPPORT FOR THE JURY'S FINDINGS AND THE JUDGMENT

Reply Points of Error 9-11 In Summary:

THE COURT OF APPEALS CORRECTLY HELD THAT THERE WAS LEGALLY CORRECT EVIDENCE TO SUPPORT THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY.

Lively's Points of Error Nine through Eleven each involve the evidentiary support for the jury's answer to Special Issue No. 2. The evidence supporting the jury's answer to Special Issue No. 2 is not only legally sufficient, it is overwhelming, and compels affirmance of the trial court's judgment.

A. *The Standard of Review for "No Evidence" or "Legal Insufficiency" Points of Error.*

In reviewing a "no evidence" point, the Court must consider only that evidence and reasonable inferences drawn therefrom in their most favorable light to support the jury's findings, rejecting all contrary or conflicting evidence and inferences. *King v. Bauer,* 688 S.W.2d 845, 846 (Tex. 1985); *Glover v. Texas General Indemnity Co.,* 619 S.W.2d 400, 401 (Tex. 1981); *Ray v. Farmers State Bank of Hart,* 576 S.W.2d 607, 609 (Tex. 1979). A "no evidence" point will not be sustained if there is *any* probative evidence to support the jury's finding. *Ray,* 576 S.W.2d at 609.

B. *The Evidence in the Record.*

The evidence supporting the jury's answer to Special Issue No. 2 is in fact essentially uncontroverted. First,

the Record demonstrates that Valero purchased from Lively all the gas Lively could legally produce during the Contract years at issue, and thus purchased the DCQ as defined in the Contract. Second, Lively's own "evidence" glaringly failed to prove its case, even under Lively's erroneous theory that G-10 tests should determine deliverability instead of the express Contract definition.

1. *The Evidence Showed that Valero Took and Paid For the Daily Contract Quantity.*

As thoroughly explained in Section IIIB, *supra*, the Contract requires Valero to take or pay for 90% of the "quantity of gas [Lively] has available for delivery," "not exceeding the maximum . . . rate of flow permitted by [Commission regulations]." At trial Valero presented extensive testimony proving it had taken the DCQ under the Contract. Lively's Application does not refute this evidence, nor did Lively succeed in controverting it at trial.

(a) *The Meaning of the Gas Market Demand Rule.*

Because the Contract does not obligate Valero to take or pay for gas not legally deliverable under the Gas Market Demand Rule, Valero introduced the 1978 Gas Market Demand Rule and offered *undisputed* testimony from former Commission Chairman Poerner and Parish, Valero's Director of Proration and Producer Affairs, concerning the Rule's adoption and meaning. (S.F. 1472-1557; 675-699; D. Ex. 7.) The substance of their testimony is set forth in Section IIIC, *supra*. To briefly reiterate, the Rule: (i) requires Valero to purchase only a proportionate share of a producer's downstream market

demand, to allocate its purchases "ratably" among its producers, and to purchase various defined categories of gas in a specified order of priority; and (ii) proscribes Lively from producing more gas than its ratable share, in accordance with the priority categories, of its purchaser's downstream market demand. (D. Ex. 7, 20-21; S.F. 324-25, 689, 693, 710, 910, 935, 989, 1007, 1050, 1494, 1552, 1556.)

(b) *Valero's Compliance with the Gas Market Demand Rule.*

Valero then showed that it had purchased from Lively the maximum quantity under the Rule, and thus took the DCQ as defined in the Contract.

(i) *Valero's Downstream Market Demand Has Dramatically Declined.*

First, Valero established through *unrebutted* evidence that its downstream market demand had declined to a point where it had been forced to drastically curtail purchases from its producers, including Lively.

Alan Anderson ("Anderson"), a specialist in natural gas economics with a Ph.D. in economic history from Johns Hopkins, and Valero's President, Becraft, explained at trial that a natural gas "market" is a function of *price.* (S.F. 533, 554, 1005.) The Commission requires Valero to charge an *inflexible* price for its gas equal to the weighted average of gas ("WACOG") plus $0.15. (S.F. 555, 571; D. Ex. 12.)[7] Over the past few years Valero's

7. This requirement is contained in the Final Order in Gas Utilities Docket No. 500 dated September 4, 1979 ("Final Order") (D. Ex. 12; S.F. 556-59.) The Appendix to the Final Order describes in great detail the WACOG calculation. (*See also* S.F. 570-71.)

WACOG plus $0.15 has equalled $4.00 to $4.20 per MMBtu of natural gas. (S.F. 555.) Therefore, Valero's sales market is the market for $4.00 gas. (*Id.*)

That market is currently virtually nonexistent. Due to many factors, including a reduction in industrial consumption and governmental policies adversely impacting demand, a natural gas glut arose approximately in 1981. (S.F. 602, 710, 713, 1040, 1495, 1483-84; D. Ex. 11A, 13A, 38, 94.) Prices for natural gas have fallen accordingly, currently to $1.50 per MMBtu. (S.F. 537.) Thus, Valero's customers can purchase gas, or use alternative fuels, at significantly lower prices than the $4.00 and above that Valero is required to charge them. (S.F. 529-34, 1012; D. Ex. 32.) As customers' contracts with Valero have expired, they have sought cheaper fuel elsewhere. (S.F. 529-34.) Valero's market has been drastically reduced. (S.F. 540, 568; 1040, 1532; D. Ex. 11A, 13A, 38, 64.) Its sales have declined from 620 billion cubic feet of gas in 1981 to 70 billion in 1986. (S.F. 540.) At the same time, its WACOG, including cost of service, has *increased*. (S.F. 571; D. Ex. 11A, 13A.)

The downstream market demand for $4.00 gas, which is Valero's market as established by the Commission, is purely and simply drying up. (S.F. 540, 568, 1040, 1532; D. Ex. 11A, 13A, 38, 94.)

(ii) *Valero's Nominations from Lively and its Other Producers Are in Accordance with its Downstream Market Demand.*

It is undisputed that *Valero has taken all of the gas available to it from Lively consistent with Valero's downstream market demand.* (S.F. 684.)

Parish explained that Valero scrupulously follows the procedures required by the Rule and set forth in § IIIC (2), *supra*. Valero introduced numerous exhibits and offered extensive testimony demonstrating systemwide ratability in accordance with the priority categories. (D. Ex. 16, 17, 18, 19, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 74; S.F. 676-78, 682-85, 684, 695-99, 1307, 1310-11, 1318-21, 1329-32, 1346-53, 1376.) In sum, Valero showed that during the Contract years in issue Valero has been ratable in its nominations and rate requests required by the Gas Market Demand Rule. (S.F. 1376.)

Valero's purchases from Lively have been reduced to virtually zero because Lively produces primarily gas well gas (S.F. 209, 693), non-priority gas, and Valero's market demand has dropped *below* the amount of *priority* gas deliverability. (D. Ex. 63, 64; S.F. 1328-31.) Thus, Valero must satisfy its market demand exclusively through ratable purchases from producers of higher-priority gas. (S.F. 1324-25.) *Valero's nominations have been ratable among the non-priority gas producers.* (S.F. 1332; D. Ex. 64.)

In sum: Valero's uncontroverted evidence showed that it has taken all the gas from Lively "available for delivery," "not exceeding the maximum . . . [production] . . . permitted by [Commission] regulations." Therefore, Valero took and paid for the DCQ under the Contract, and the jury so found.

(c) *Lively's Failure to Address Valero's Evidence That It Took the DCQ.*

In its Application, Lively *does not even attempt to controvert* Valero's evidence that the Gas Market Demand

Rule limits production to the pipeline's market demand, and that Valero has taken all the gas from Lively for which it has a downstream market demand. Lively's brief argument under Ninth through Eleventh Points of Error focuses *exclusively* on the same irrelevant refrain sung throughout its Brief: that the Rule does not "abrogate" Valero's alleged obligation to pay the DCQ. As repeatedly explained, Lively's argument ignores the *Contract*, which limits Valero's payment obligation to payment for a quantity of gas that Lively can legally produce and Valero can legally take.

Nonetheless, based on its same specious reasoning, Lively takes issue only with the testimony by Peat, Marwick, Main, and Company's Herbert Warner ("Warner"), who simply summarized that Valero had taken the DCQ assuming that Valero's takes had equalled its downstream market demand. (D. Ex. 91; S.F. 1406-07.) This assumption was supported by Valero's essentially uncontroverted evidence, and the jury correctly answered Special Issue No. 2 "no."

The evidence that Valero purchased the DCQ is so overwhelming and unchallenged as to prove Valero's compliance with the Contract as a matter of law. There is *certainly* sufficient evidence, therefore, to compel this Court to overrule Lively's "no evidence" points of error.

(d) *Evidence of Force Majeure Supported the Jury's Answer to Special Issue No. 2.*

The jury's answer to Special Issue No. 2 is additionally supported by evidence of *force majeure* conditions excusing Valero's performance under the Contract. As set forth in § IIIB, *supra*, the Contract's *force majeure* clause

provides that a party's obligations are suspended by *force majeure* events including "temporary failure of wells or sources of supply of gas, or markets" and "any other causes, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming suspension in which by the exercise of due diligence such party is unable, wholly or in part, to prevent or overcome . . . ." (P. Ex. 1, pp. 26-26A, art. XII, §§ 12.2.) The evidence in the Record is not only ample but in fact uncontroverted that Valero's markets have failed miserably, a *force majeure* condition as defined by the Contract. (Id.; S.F. 573; *see* § VIII (B)(1)(b) herein.) Moreover, no one contends that this failure of markets was reasonably within Valero's control, that it could have been prevented by Valero, or that it was foreseeable. Therefore, the jury had ample basis to answer Special Issue No. 2 "no" on the basis of *force majeure* alone. (S.F. 536, 593-94; *see Kodiak*, discussed in § IVB(2), *supra.*)

2. *Lively's Own "Evidence" On "Deliverability" Was So Discredited That It Warranted the Jury's Rejection.*

At trial, Lively's sole method for attempting to prove its case was through evidence of "deliverability tests" allegedly conducted on the wells at issue. Ignoring the Contract's definition limiting "Deliverability" to maximum production under *Commission rules and regulations,* Lively contended that "G-10" tests demonstrated Deliverability. G-10 tests are mechanical tests that measure the flow of gas over a twenty-four hour period after a forty-eight hour pre-flow. (S.F. 227-228.) The results are recorded on verified "G-10" forms filed with the Com-

mission. (S.F. 972-973, 977.) The tests are designed to help the Commission determine how much gas a well is capable of producing under normal operating conditions. (S.F. 814, 822.) Lively claimed that by failing to take-or-pay for 90% of the volumes reflected on the G-10 tests, Valero failed to take the DCQ.

Even accepting *arguendo* Lively's erroneous assumption that "Deliverability" under the Contract is strictly based on G-10 volumes, with no limitations pursuant to the Gas Market Demand Rule, Lively failed to prove its case "by a preponderance of the credible evidence," because its evidence was devoid of believability.

Lively's purported "expert" on damages, Max Powell ("Powell"), admitted that if Lively's reported G-10 volumes were wrong, *all of Lively's calculations were wrong*. (S.F. 442.) It became crystal clear at trial, even through Lively's own witnesses, that the volumes Lively reported on its G-10 forms had no basis in reality.

(a) *The Requisites of a True G-10 Test.*

The Commission has established certain mandatory guidelines for conducting G-10 tests. Lively's own witness Jimmy Condra ("Condra"), president of the company that services Lively's wells, testified that a valid G-10 test entails: (i) *pre-flow* of the well for 48 hours before the twenty-four hour "G-10" test; (ii) an additional determination that the flow has in fact *stabilized* during the pre-flow and before the actual test; and (iii) the presence of normal operating conditions. (S.F. 227-28, 253-55, 277.) Moreover, the volumes reported from the twenty-four test period cannot exceed 75% of the average of the 48 hour pre-flow volumes. (*Id.*)

The 48-hour pre-flow and stabilization requirements are essential to the validity of the tests since, as Condra admitted, the Lively wells "spurt" or peak in production when they are "opened up" after a period of no production, and require time to taper into normal production. (S.F. 274-76, 952.) Condra conceded that *a G-10 test run on a "spurt" day is not a "true" G-10 test.* (S.F. 277.)

(b) *Lively Did Not Prove that "True" G-10 Tests Were Ever Conducted.*

Condra swore to so many different stories about conducting G-10 tests that the jury could easily have decided *no* G-10 tests were ever conducted. First, he took two inconsistent positions in his deposition testimony which was read to the jury. He admitted that he had not conducted a G-10 test for five years. (S.F. 600-661.) However, he also claimed in deposition that his pumpers Mallie Turner ("Turner") or Foy Strickland *had* performed G-10 tests on the wells since 1984, and that Turner had been responsible for the Lively wells for a significant period of time before that. (S.F. 660-62.)

Turner in *his* deposition flatly contradicted Condra and testified that he *had never run a G-10 test* and did not know who, if anyone, ran G-10 tests in Condra's organization. (S.F. 952-53, 955.) Condra then changed his story again for trial. On direct examination he testified he used meter charts fresh off the wells' production meters to prepare the G-10 forms. (S.F. 228-29, 233.)

Condra's testimony not only conflicted with that of his own employee, it was internally inconsistent: he testified on direct that he notified Valero and the Commission of the date of the G-10 test. (S.F. 240, 271.)

On cross-examination, Condra revised his testimony yet again and conceded that he never really "tested" the Lively wells on a particular day, but rather gathered G-10 data from the meter charts *sometime* during a three month period. (S.F. 271-74.)

The internal inconsistencies in Condra's testimony rendered it so doubtful that the jury would have been justified in rejecting it on that basis alone.

(c) *Even Assuming Condra Conducted G-10 Tests, They Were Not Conducted in Accordance With Commission Requirements.*

Even assuming *arguendo* the truth of Condra's latest sworn contention that he used meter charts to conduct G-10 tests (S.F. 232), his reported "results" were invalid. (D. Ex. 27.) As Condra admitted, Lively's production log volumes should track reported G-10 volumes. (S.F. 663.) The evidence showed, however, that he often recorded numbers on the G-10 forms that bore no relation to corresponding numbers on Lively's production logs. (D. Ex. 27, S.F. 740-883.) Moreover, Lively's own production logs, Charts Inc. Statements (production statements prepared by "reading" Lively's meter charts), and production reports filed with the Commission on Form P-2 proved that Lively's recorded G-10 volumes were invalid under Commission requirements. (D. Ex. 27; S.F. 740-883.)

Parish gathered relevant information produced by Lively in discovery, including Lively's actual daily production logs, Charts Inc. Statements, and Commission Form P-2 production reports, inputted it into a computer, and prepared graphs showing the *actual* production per

day for particular wells during months in which Lively reported that a G-10 test was conducted. (S.F. 740-42, 753, 802-03; D. Ex. 27.) Parish's graphs revealed that: (i) *many of Lively's G-10 reports referenced fabricated "tests" conducted during months in which there was no production from the wells;* (ii) many of the reported volumes were from "spurt" days with *no* pre-flow, inflating the volumes; and (iii) many of the reported volumes exceeded 75% of the average of 48-hour pre-flow volumes. (D. Ex. 27; 442, 805-28.) To cite just one of many examples, Lively's production reports showed that Aldwell Ranch Well No. 22-8 did not produce *at all* during May 1983. Nonetheless, Lively disingenuously reported "results" of a G-10 test on this well during May of 1983 and, even more baldly, concocted a 25% increase in its reported production from the last G-10 test. (S.F. 812-13; D. Ex. 27.)

(d) *Other Evidence Demonstrated the G-10s' Invalidity.*

Travis Crow, Director of Reserve Evaluation at Valero, analyzed the wells' historical performance and Lively's studies of the wells' reserves, and determined that Lively's reported G-10 volumes were approximately *double* the true physical ability of the wells to produce. (D. Ex. 56, 57, 58; S.F. 1191-1300.) Moreover, Herbert Warner compared Lively's reported G-10 volumes with Lively's *actual production* on days Valero was legally able to take —and was purchasing—all the gas Lively could physically produce, and found that Lively's *actual deliveries* were only 76% of its reported G-10 volumes. (S.F. 1414, 1425-26.)

It is the jury's *exclusive* province to weigh the credibility of the witnesses and determine the weight to be accorded their testimony. Based on the extensive evidence undermining Lively's G-10s even from its own witnesses, the jury understandably could have decided that Lively concocted G-10 tests instead of conducting them, or at least failed to prove any damages with reasonable certainty, and thus that Lively did not prove its case even under its own faulty assumptions.

X. LIVELY'S ERRONEOUS PREEMPTION ARGUMENT

Reply Points of Error 12-13 In Summary:

THE COURT OF APPEALS' HOLDING THAT THE CONTRACT LIMITS VALERO'S PAYMENT OBLIGATION TO THE AMOUNT THAT CAN BE LEGALLY PRODUCED DOES NOT RENDER THE GAS MARKET DEMAND RULE EITHER PREEMPTED BY THE NATURAL GAS POLICY ACT OR VIOLATIVE OF THE COMMERCE CLAUSE.

In its Application, Lively makes two arguments it alleged for the first time in its Motion for Rehearing: that the Gas Market Demand Rule is preempted by the Natural Gas Policy Act, and that it violates the Commerce Clause.

First, in its Appellant's Brief and Reply Brief Lively never controverted the validity of the Gas Market Demand Rule *per se*, or the Commission's jurisdiction over Lively and Valero. It cannot raise these points of error for the first time in a motion for rehearing. *See Gillen v. Diadrill,*

Inc., 624 S.W.2d 259, 264 (Tex. App.—Corpus Christi 1981, writ dism'd).

Moreover, its argument is again a red herring because it is based on the same flawed contention that the court of appeals held that the Gas Market Demand Rule unilaterally abrogated contract rights. It did not; the court found that the parties *agreed* that the payment obligation was limited to legal deliverability.

Neither *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board of Mississippi*, 106 S. Ct. 709 (1986), nor *McGoldrick Oil Co. v. United Gas Pipe Line Co.*, C.A. No. H-84-4971 (September 17, 1987), are applicable. In *Transco*, which did not involve the interpretation of a take-or-pay provision, the Court discussed the application of a Mississippi state ratable take order to an *interstate* pipeline, not an intrastate pipeline like Valero. In holding the ratable take order preempted for interstate pipelines, the Court noted in part that Transco's compliance with Mississippi's law "disturbs the uniformity of the *federal* scheme, since *interstate* pipelines would be forced to comply with *varied* state regulations of their purchasing practices." 106 S. Ct. at 712. *Transco* does not apply here, where the purchaser is an *intrastate* pipeline, and where the parties *agreed* to limit payment obligations to a quantity that can be produced under Commission regulations.

Moreover, the order in *McGoldrick* is also inapposite. First, defendant United Gas is again an interstate pipeline. Also, the *McGoldrick* court noted that "the Texas rule is relied on by United solely to free itself of a contractual obligation. . . ." Valero, however, is not relying on the Gas Market Demand Rule to unilaterally *free*

Valero of a contractual obligation. Rather, in this case the Contract does not *impose* on Valero any obligation to pay for gas it cannot legally take.[8]

CONCLUSION AND PRAYER

The Record and Texas law demonstrate conclusively that Lively's Application should be denied.

WHEREFORE, Valero prays that the Application be denied, or alternatively that the court of appeals' judgment be affirmed, and that Valero recover its costs of court in this appeal and such other relief to which it may be justly entitled.

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8. Lively's assertion that the interstate/intrastate distinction is irrelevant is also wrong, even though it need not be considered since the cited cases are factually not on point. Lively would welcome the interference of the Federal Energy Regulatory Commission in strictly intrastate dealings, when even the federal courts themselves have not gone this far. The logical extension of Lively's argument is that the Texas Railroad Commission, and the Texas Statutes on conservation, are all entirely preempted by the federal regulatory scheme. It is not surprising that none of the cases Lively cites support this proposition.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Respondent's Reply to Application for Writ of Error has been served on opposing counsel by certified mail, return receipt requested, on the 27th day of July, 1988.

/s/ CARRIN F. PATMAN
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NO. 04-87-00380-CV

IN THE COURT OF APPEALS
FOURTH SUPREME JUDICIAL DISTRICT
OF TEXAS AT SAN ANTONIO

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants,

vs.

VALERO TRANSMISSION COMPANY,
Appellee.

ON APPEAL FROM THE
DISTRICT COURT OF SUTTON COUNTY
112TH DISTRICT COURT OF TEXAS

BRIEF OF AMICII CURIAE IN SUPPORT OF APPELLANTS' RESPONSE POINT ONE

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PAGE RELEVANT TO MOTION TO DISMISS:

III.

AN INCORRECT HOLDING THAT THE TEXAS CONSERVATION AND PRORATIONING STATUTES AND REGULATIONS INTERFERE WITH TAKE-OR-PAY OBLIGATIONS WILL RESULT IN PRE-EMPTION OF THOSE STATUTES AND REGULATIONS BY FEDERAL LAW.

In *Transco* (discussed previously at page 6 of this Brief), the United States Supreme Court recognized that take-or-pay provisions in gas purchase contracts are not abrogated or modified by State proration and ratable-take regulations. To the contrary, such take-or-pay contract provisions take priority over state regulations.[15] The Supreme Court expressly recognized the validity of take-or-pay provisions and, in pre-empting the ratable-take orders of Mississippi, reasoned that forcing the pipeline company to purchase gas from producers other than those with whom it had fixed purchase requirements would expose it to liability from those contracted producers under take-or-pay clauses. The result would be that those additional costs would be passed through to consumers. The Supreme Court concluded that the Mississippi ratable-take regulations interfered with the

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15. While no authority has been found that applies the holding of *Transco* to intrastate pipelines, that application would be logical. Since the Natural Gas Policy Act, 15 U.S.C. Sec. 3310 *et seq.*, regulates first sales of gas, regardless whether destined for interstate or intrastate markets, pre-emption by that federal statute would probably apply as well to purchases by intrastate pipeline companies. Moreover, from a practical standpoint, it seems impossible to limit the effects of the holding in *Transco* only to interstate pipeline companies. It is simply not feasible for the Railroad Commission to promulgate and enforce separate ratable-take systems for interstate and intrastate pipeline companies which would be equitable and in furtherance of the State conservation and proration laws.

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NO. 89-935

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants

v.

VALERO TRANSMISSION COMPANY,
Appellee

On Appeal From The Court of Appeals For The Fourth Supreme Judicial District of Texas

APPELLANTS' RESPONSE TO MOTION TO DISMISS APPEAL AND, ALTERNATIVELY, TO AFFIRM JUDGMENT

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NO. 89-935

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants

v.

VALERO TRANSMISSION COMPANY,
Appellee

On Appeal From The Court of Appeals For The Fourth Supreme Judicial District of Texas

APPELLANTS' RESPONSE TO MOTION TO DISMISS APPEAL AND, ALTERNATIVELY, TO AFFIRM JUDGMENT

To The Honorable United States Supreme Court:

Appellants[1] file this response to Appellee's Motion to Dismiss Appeal and, Alternatively, to Affirm Judgment ("Appellee's Motion to Dismiss Appeal").

I.

This Appeal Is Within This Court's Jurisdiction Under 28 U.S.C. § 1257

The amendment of 28 U.S.C. § 1257 ("Section 1257") does not affect Appellants' right to file this appeal or this

1. A complete list of parties is on page ii of Appellants' Jurisdictional Statement. Lively Exploration Company has no parent or subsidiary companies.

Court's jurisdiction over this appeal. Section 7 of Public Law 100-352 ("Section 7") states:

> The amendments made by this Act shall take effect ninety days after the date of the enactment of this Act, except that such amendments shall not apply to cases pending in the Supreme Court on the effective date of such amendments or affect the right to review or the manner of reviewing the judgment or decree of a court which was *entered* before such effective date.[2]

The amendment thus does not affect the right to appeal from a judgment "entered" before September 25, 1988.

The date the judgment appealed from became appealable to this Court is irrelevant to whether the new or the old version of Section 1257 applies. Appellee relies on a quotation from legislative history (Appellee's Motion to Dismiss Appeal, p. 6). The use of the phrase "subject to appeal" in the House Report merely indicates that the law governing timing of appeal applies only to judgments which are appealable. It does not indicate that the date a judgment becomes appealable controls whether a judgment comes within the exception in the amendment. The phrase "that have been *issued* prior to the effective date of this act" states clearly that the relevant date is not the date the judgment becomes subject to appeal, but instead the date of *issuance,* or entry, of the judgment.

Since Appellee does not, and could not, dispute that (1) the judgment of the Texas Court of Appeals ("Court of Appeals"), and not the judgment of the Texas Supreme Court, is the judgment appealed from (Appellee's Motion to Dismiss Appeal, p. 3) and (2) the judgment of the

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2. Review of Cases By the Supreme Court, Pub.L. No. 100-352, § 7, 102 Stat. 662 (1988). The full text of Public Law 100-352 appears on pages 1a - 6a of the Supplemental Appendix. Emphasis is added throughout except where otherwise indicated.

Court of Appeals was entered on March 31, 1988, and modified May 18, 1988, it necessarily follows that the amendment does not eliminate this Court's jurisdiction over this appeal.

The fact that "the time limit for applying for relief runs from the date the state Supreme Court refuses writ or rehearing, not from the date of the court of appeals decision" (Appellee's Motion to Dismiss Appeal, p. 4) does not mean that the date of the denial of writ or rehearing is determinative or even relevant to entry of judgment under Section 7. Under Section 7 the controlling date is the date the judgment appealed from is *"entered,"* not the date the 90-day docketing period begins to run.

This Court should not be guided by *Chicago Great Western Railroad Co. v. Basham,* 249 U.S. 164 (1919), or *Andrews v. Virginian Railway Co.,* 248 U.S. 272 (1919). Both of these cases involved interpretation of the 1916 amendment to the Judicial Code, Act of September 6, 1916, § 7, 39 Stat. 726 (1916). The 1916 amendment, which also referred to entry of a judgment, and *Chicago Great Western* and *Andrews,* which held that entry of judgment is synonymous with finality of judgment, were drafted in an era twenty years prior to the adoption of the Federal Rules of Civil Procedure. The 1938 adoption of the Federal Rules of Civil Procedure was a watershed event that revolutionized procedure in federal court, led to equally sweeping changes in state procedure, and created universally held notions of entry of judgment which are completely at odds with the view of *Chicago Great Western* and *Andrews* that a judgment is not entered until state remedies have been exhausted. In light of the adoption of the Federal Rules of Civil Procedure and the fact that courts and lawyers since 1938 have universally considered entry of judgment as being a purely ministerial

act of the court clerk, *Chicago Great Western* and *Andrews* should be viewed only as interpretations shortly after the turn of the century that do not reflect contemporary meaning of "entry" of judgment.[3]

Prior to the adoption of Rule 58 of the Federal Rules of Civil Procedure, "[p]ractice under the former [Equity] [R]ule was quite unsatisfactory. A number of matters regarding the entry of judgment were not clearly resolved by the rule and differing views were taken in the lower courts." *Wright & Miller, supra* n.3, § 2782 at 10. The adoption of Rule 58 resolved the uncertainty and ambiguity surrounding the term "entry of judgment" and introduced a standard definition of the term.[4] Rule 58 "requires two distinct acts to coincide before there is an effective judgment. Every judgment must be 'set forth on a separate document' and must be entered in the docket as provided in Rule 79(a)." *Id.*, § 2781 at 8.

Entry of judgment occurs when the two acts described in Rule 58 occur, not when state appellate remedies are exhausted. Entry of judgment is the ministerial act of the clerk of entering on court records the judgment rendered by the Court.[5] A judgment was entered by the Court of Appeals on March 31, 1988, even though that judgment was not final with respect to jurisdiction of this Court and state appellate remedies were not yet exhausted.

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3. *See* Wright & Miller, Federal Practice and Procedure: Civil 2d § 1002 at 8 (1987), § 1008 at 47; Carey, *In Favor of Uniformity*, 3 F.R.D. 507 (1943).

4. Rule 58 was completely rewritten in 1963 to further eliminate uncertainty as to the meaning of the term. Wright & Miller, *supra* n. 3, § 2781 at 8.

5. *United States v. Indrelunas*, 411 U.S. 216, 219-21 (1973); *United States v. F. & M. Schaefer Brewing Co.*, 356 U.S. 227, 232-36 (1958). In Texas, "[e]ntry of a judgment is the act by which evidence of the judicial act [of rendering judgment] is afforded." 47 Tex. Jur. 3d *Judgments* § 4 at 503 (1986).

The March 31, 1988, judgment (Appendix, p. 37) concludes: "*Entered* this 31st day of March, 1988." No other judgment was entered after March 31, 1988. Thus, the judgment appealed from was "entered" on March 31, 1988, even if it did not become a final judgment for purposes of appeal to this Court until the Texas Supreme Court denied Appellant's application for writ of error on June 7, 1989.

Section 7 does not refer to the entry of *final* judgment or entry of an order making a judgment of the lower court *final*. Instead, Section 7 excepts from the amendment any judgment or decree that was "*entered*" before September 25, 1988. This Court must interpret Section 7 in light of the contemporary universal meaning of entry of judgment and *in pari materia* with Rule 58. *See United States v. Vest*, 639 F.Supp. 899, 909 (D. Mass. 1986), *aff'd* 813 F.2d 477 (1st Cir. 1987). Under Rule 58 and the universally accepted meaning of entry of judgment, judgment was entered on March 31, 1988.

Appellants' decision to file a jurisdictional statement, and not a petition for writ of certiorari, was a studied one. After careful examination of the amended version of Section 1257, counsel for Appellants concluded that the judgment appealed from was the judgment of the Court of Appeals, in reliance on *Interstate Circuit, Inc. v. City of Dallas*, 390 U.S. 676, 678 n.1 (1968), and that the date on which that judgment was entered was March 31, 1988, in light of (1) Rule 58, (2) the universally understood meaning of entry of judgment, and (3) the fact that the March 31, 1988, judgment explicitly states that judgment was entered on that date, Appendix, p. 37. Since the amended version of Section 1257 does not refer to the entry of *final* judgment or entry of an order making a judgment *final*, no reasonable lawyer could possibly

predict that the amended version of Section 1257 could have the meaning urged by Appellee. Such an interpretation is at odds with the contemporary and universally understood meaning of the word "entered" that appears in the amended version of Section 1257 and with the Clerk of the Supreme Court's interpretation of Section 7. Supplemental Appendix, p. 26a.

Alternatively, should the Court read Section 7 as vitiating Appellants' right to appeal and the Court's jurisdiction over this appeal, it should treat Appellants' Jurisdictional Statement as a petition for writ of certiorari. This would be consistent with the regular practice of the Clerk of the Supreme Court. Supplemental Appendix, p. 25a. Appellants should not lose their right to have their filing considered as a petition for writ of certiorari by virtue of their good faith reliance on the commonly accepted meaning of "entered" and Rule 58 of the Federal Rules of Civil Procedure.

II.

Appellants Timely Raised The Federal Question On Which It Appeals To This Court

Appellee argues that points of error Nos. 23 and 24 "could have been raised before the motion for rehearing." (Appellee's Motion to Dismiss Appeal, p. 17). Points of error Nos. 23 and 24 could not have been properly raised prior to the motion for rehearing since the opinion of the Court of Appeals, and not any action of the trial court, raised the federal question. Prior to the opinion of the Court of Appeals, all Texas courts passing on the question rejected a Gas Market Demand Rule ("the Rule") defense to a take-or-pay claim based on the Rule. *See* Appendix, pp. 90-96. In addition, the history of the Rule was clear that the Rule does not apply to relieve Appellee

of its obligations under the "take-or-pay" provision of the natural gas contract. *See* Appendix, pp. 87-90. Thus, the federal question was timely presented, since the Court of Appeals' holding was a surprise that could not be reasonably anticipated from any prior decision.

Unless the Court of Appeals' decision had a basis in precedent and thus could be reasonably anticipated, Appellants had no responsibility to raise hypothetical points of error based on every possible novel application of the Rule by the Court of Appeals. The essence of this Court's holding in all of the cases cited on page 5 of the Jurisdictional Statement is that a litigant is not responsible for (1) anticipating that the appellate court will uphold the departure of the trial court from settled law and all of the various reinterpretations of the law that the appellate court *might* issue in the course of upholding the court's action or (2) marshalling hypothetical constitutional challenges to all of those various reinterpretations.

In *Great Northern Railway Co. v. Sunburst Oil & Refining Co.*, 287 U.S. 358, 367 (1932), the Court held that the rule that a constitutional question first raised on a motion for rehearing is untimely does not apply where the grounds of the decision appealed from supply a new and unexpected basis for a claim of denial of a federal right. In *Brinkerhoff-Faris Trust & Savings Co. v. Hill*, 281 U.S. 673, 678 (1930), the Court held that a federal question is timely raised in a petition for rehearing where it arises from a construction placed upon a statute that is at variance with prior law. In neither of these cases, nor in *Missouri ex rel. Missouri Insurance Co. v. Gehner*, 281 U.S. 313 (1930), did the Court dismiss the appeal simply because other points of error had been raised earlier that related to the point of error raised in the motion for rehearing.

In *Herndon v. State of Georgia*, 295 U.S. 441, 445 (1935), relied upon by Appellee (Appellee's Motion to Dismiss Appeal, p. 18), the Court held that the appellant should have been aware of a similar ruling in another case and anticipated the possibility that similar ruling would be followed. No such ruling existed here, and all precedent and the history of the Rule indicated that the Rule's meaning with respect to contract rights was a settled question.

Unlike *Clark v. Jeter*, 486 U.S. 456 (1988), which is cited on page 19 of Appellee's Motion to Dismiss Appeal, Appellants did adequately present the preemption and commerce clause argument to the Court of Appeals on motion for rehearing, Appendix, p. 57, and to the Texas Supreme Court, Appendix, pp. 77-78, 129. *See* Jurisdictional Statement, pp. 4-6.

III.

Appellants Have Raised A Substantial Federal Question

Appellee argues that "independent state law grounds (the other Contract provisions interpreted in accordance with state law) support the Court of Appeals' judgment." (Appellee's Motion to Dismiss Appeal, p. 21). This is untrue. Article XIII, ¶ 13.1, of the Contract and the Rule were essential to the Court of Appeals' interpretation of the Contract. This Court's test for independent state grounds announced in *Michigan v. Long*, 463 U.S. 1032, 1041 (1983), requires that "the state court decisions indicate clearly and expressly that it is alternatively based on bona fide separate, adequate, and independent grounds." No such indication appears in the Court of Appeals' opinion. The mere fact that the opinion sets out provisions of the Contract does not suggest that the court believed that those provisions serve as separate, adequate, and

independent grounds. Moreover, the decision does not "indicate *clearly* and *expressly* that it is alternatively based on" grounds other than the Rule. Since it appears that the ground for the Court of Appeals' decision is interwoven with and dependent upon the federal question presented by Appellants, no basis exists for Appellee's argument that independent state law grounds support the Court of Appeals' judgment.[6] In addition, the Court of Appeals' holding that the "rule was relevant and material to prove or disprove that there was a breach of the 'take-or-pay' provision" (751 S.W.2d at 652, Appendix, p. 4) was based on an interpretation of the Rule and not an interpretation of the Contract, since even if the Contract had not included a government regulation clause all laws and regulations would become a part of the Contract and govern the transaction. *Wessely Energy Corp. v. Jennings,* 736 S.W.2d 624 (Tex. 1987); *Longever v. Miller,* 124 Tex. 80, 76 S.W.2d 1025 (1934).

Appellee argues that "no federal question would be presented even were Lively's interpretation of the court of appeals opinion correct." (Appellee's Motion to Dismiss Appeal, p. 21). However, Appellee's analysis of the cases cited by Appellants on preemption and the commerce clause is wrong. *See* Jurisdictional Statement, pp. 11-29. Additional authority for Appellants' position on preemption and commerce clause violation was provided by the December 13, 1989, opinion of the Austin Court of Appeals in *Lone Star Gas Co. v. Railroad Commission of Texas,* Supplemental Appendix, pp. 7a-23a. The court there invalidated portions of the Rule on preemption grounds and suggested (footnote 4) that the remainder of

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6. *Maryland v. Garrison,* 480 U.S. 79, 84 n. 7 (1987) ("[T]he 'state court decision fairly appears to rest primarily on federal law, or to be interwoven with the federal law . . . .' "] (quoting *Michigan v. Long,* 463 U.S. 1032, 1040 (1983)).

the Rule may also be invalid. *Lone Star's* conclusion that the Rule is invalid *per se* adds considerable weight to Appellants' argument that this case deserves the Court's attention. *See* Jurisdictional Statement, pp. 12-13.

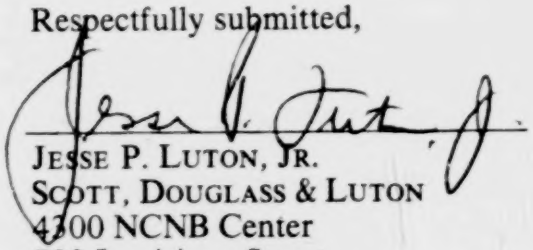
Appellee argues that this appeal presents no federal question, since the contract at issue is an intrastate gas sales contract. (Appellee's Motion to Dismiss Appeal, pp. 21-22). This point is addressed in the Jurisdictional Statement, pp. 25-26. In addition, *Lone Star* invalidated portions of the Rule as they apply to an intrastate pipeline system, Supplemental Appendix, p. 12a. The case cited by Appellee, *Exxon Corp. v. Eagerton*, 462 U.S. 176 (1983), is inapplicable because the specific statute there involved was specifically sanctioned by § 602(a) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3432(a). *Id.* at 187.

IV.

Conclusion

For these reasons and the reasons in the Jurisdictional Statement, this Court should note probable jurisdiction of this appeal.

Respectfully submitted,



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SUPPLEMENTAL APPENDIX

PUBLIC LAW 100-352 [S. 952]; June 27, 1988

REVIEW OF CASES BY THE SUPREME COURT

An Act to improve the administration of justice by providing greater discretion to the Supreme Court in selecting the cases it will review, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 1. Section 1252 of title 28, United States Code, and the item relating to that section in the section analysis of chapter 81 of such title, are repealed.

Review of Decisions Invalidating State Statutes

Sec. 2. (a) Section 1254 of title 28, United States Code, is amended by striking out paragraph (2) and redesignating paragraph (3) as paragraph (2).

(b) The section heading for section 1254 of such title is amended by striking out "appeal;".

(c) The item relating to section 1254 in the section analysis of chapter 81 of title 28, United States Code, is amended by striking out "appeal;".

Review of State Court Decisions Involving Validity of Statutes

Sec. 3. Section 1257 of title 28, United States Code, is amended to read as follows:

"§ 1257. State courts; certiorari

"(a) Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court by writ of certiorari where the validity of a treaty or statute of the United States is drawn in question or where the validity of a statute of any State is drawn in question on the ground of its being repugnant to the Constitution, treaties, or laws of the United States, or where any title, right, privilege, or immunity is specially set up or claimed under the Constitution or the treaties or statutes of, or any commission held or authority exercised under, the United States.

"(b) For the purposes of this section, the term "highest court of a State" includes the District of Columbia Court of Appeals.".

Review of Decisions from Supreme Court of Puerto Rico

Sec. 4. Section 1258 of title 28, United States Code, is amended to read as follows:

"§ 1258. Supreme Court of Puerto Rico; certiorari

"Final judgments or decrees rendered by the Supreme Court of the Commonwealth of Puerto Rico may be reviewed by the Supreme Court by writ of certiorari where the validity of a treaty or statute of the United States is drawn in question or where the validity of a statute of the Commonwealth of Puerto Rico is drawn in question on the ground of its being repugnant to the Constitution, treaties, or laws of the United States, or where any title, right, privilege, or immunity is specially set up or claimed under the Constitution or the treaties

or statutes of, or any commission held or authority exercised under, the United States.".

Conforming Amendments

Sec. 5. (a) The items relating to sections 1257 and 1258 in the section analysis of chapter 81 of title 28, United States Code, are amended to read as follows:

"1257. State courts; certiorari

"1258. Supreme Court of Puerto Rico; certiorari.".

(b) Section 2101(a) of title 28, United States Code, is amended by striking out "sections 1252, 1253 and 2282" and inserting in lieu thereof "section 1253".

(c) Section 2103 of title 28, United States Code, and the item relating to such section in the table of sections for chapter 133 of such title are repealed.

(d)(1) Section 2104 of title 28, United States Code, is amended to read as follows:

"§ 2104. Reviews of State court decisions

"A review by the Supreme Court of a judgment or decree of a State court shall be conducted in the same manner and under the same regulations, and shall have the same effect, as if the judgment or decree reviewed had been rendered in a court of the United States.".

(2) The item relating to section 2104 in the section analysis of chapter 133 of title 28, United States Code, is amended to read as follows:

"2104. Reviews of State court decisions.".

(e) Section 2350(b) of title 28, United States Code, is amended by striking out "1254(3)" and inserting in lieu thereof "1254(2)".

Amendments to Other Laws

Sec. 6. (a) Section 310 of the Federal Election Campaign Act of 1971 (2 U.S.C. 437h) is amended by repealing subsection (b), and by striking out "(a)" before "The Commission".

(b) Section 2 of the Act of May 18, 1928 (25 U.S.C. 652), is amended by striking out ", with the right of either party to appeal to the United States Court of Appeals for the Federal Circuit".

(c) The last sentence of section 203(d) of the Trans-Alaska Pipeline Authorization Act (43 U.S.C. 1652(d)) is amended to read as follows: "An interlocutory or final judgment, decree, or order of such district court may be reviewed only upon petition for a writ of certiorari to the Supreme Court of the United States.".

(d) Section 209(e)(3) of the Regional Rail Reorganization Act of 1973 (45 U.S.C. 719(e)(3)) is amended—

(1) in the first sentence by striking out ", except that" and all that follows through the end of the sentence and inserting in lieu thereof a period; and

(2) in the second sentence by striking out "petition or appeal shall be filed" and inserting in lieu thereof "such petition shall be filed in the Supreme Court".

(e) Section 303(d) of the Regional Rail Reorganization Act of 1973 (45 U.S.C. 743(d)) is amended to read as follows:

"(d) Review.—A finding or determination entered by the special court pursuant to subsection (c) of this section or section 306 of this title shall be reviewable only upon petition for a writ of certiorari to the Supreme

Court of the United States. Such review is exclusive and any such petition shall be filed in the Supreme Court not more than 20 days after entry of such finding or determination.".

(f) Section 1152(b) of the Omnibus Budget Reconciliation Act of 1981 (45 U.S.C. 1105(b)) is amended—

(1) in the first sentence by striking out ", except that" and all that follows through the end of the sentence and inserting in lieu thereof a period; and

(2) in the second sentence by striking out "petition or appeal shall be filed" and inserting in lieu thereof "such petition shall be filed in the Supreme Court".

(g) Section 206 of the International Claims Settlement Act of 1949 (22 U.S.C. 1631e) is amended by striking out "sections 1252, 1254, 1291, and 1292" and inserting in lieu thereof "chapter 83".

(h) Section 12(a) of the Act of May 13, 1954, commonly known as the Saint Lawrence Seaway Act (33 U.S.C. 988(a)), is amended by striking out "1254(3)" and inserting in lieu thereof "1254(2)".

(i) Section 25(a)(4) of the Federal Insecticide, Fungicide, and Rodenticide Act (7 U.S.C. 136w(a)(4)) is amended by—

(1) repealing clause (ii) of subparagraph (E); and

(2) striking out the following:

"(E) Judicial Review.—

"(i) Any", and inserting in lieu thereof the following:

"(E) Judicial Review.—Any".

Effective Date

Sec. 7. The amendments made by this Act shall take effect ninety days after the date of the enactment of this Act, except that such amendments shall not apply to cases pending in the Supreme Court on the effective date of such amendments or affect the right to review or the manner of reviewing the judgment or decree of a court which was entered before such effective date.

Approved June 27, 1988.

IN THE COURT OF APPEALS
THIRD DISTRICT OF TEXAS
AT AUSTIN

ON REMAND

No. 3-88-012-CV

LONE STAR GAS COMPANY, ET AL.,
Appellants

v.

THE RAILROAD COMMISSION OF TEXAS, ET AL.,
Appellees

FROM THE DISTRICT COURT OF TRAVIS COUNTY,
299TH JUDICIAL DISTRICT NO. 414,537,
HONORABLE JOE B. DIBRELL,
JUDGE PRESIDING

Appellants filed suit in the district court of Travis County pursuant to the Declaratory Judgments Act, Tex. Civ. Prac. & Rem. Code Ann. §§ 37.001-37.011 (1986 & Supp. 1989) and the Administrative Procedure and Texas Register Act, Tex. Rev. Civ. Stat. Ann. art. 6252-13a, § 12 (Supp. 1989) (APTRA), seeking a declaration as to the validity and applicability of certain rules promulgated by the Texas Railroad Commission. After a trial on the merits, the district court rendered judgment that the Commission did not exceed its authority by enacting the rules, but dismissed the cause for lack of ripeness.

The trial court was called upon to declare (1) whether the rules in question were valid and (2) their applicability to certain described fact situations. By its judgment, the trial court purported to find that the rules were valid, but then proceeded to order a dismissal as to the entire cause on the basis that the request for declaratory relief applying the rules was premature. The two issues, although they might have been, were not severed; instead, the matter was before us for review on a judgment of dismissal. As our Supreme Court has noted many times, "[i]t is elementary that a dismissal is in no way an adjudication of the rights of parties; it merely places the parties in the position that they were in before the court's jurisdiction was invoked just as if suit had never been brought." Crofts v. Eighth Court of Appeals, 362 S.W.2d 101, 104 (Tex. 1962).

In an unpublished opinion, we held that the court erred in dismissing the instant cause, because the matter was ripe and the trial court was duty-bound to decide all the issues properly before it. *See* Bellegie v. Texas Board of Nurse Examiners, 685 S.W.2d 431, 434 (Tex. App. 1985, no writ). We reversed the judgment of dismissal and remanded the matter to the trial court for further proceedings and rendition of a final declaration of all matters in issue. Because a dismissal does not operate as an adjudication, we held that the attempt to decide one issue was of no legal effect in light of dismissal of the entire cause, and we thus declined to render what we believed to be an advisory opinion on a matter not properly before this Court.

The Supreme Court, however, reversed our decision and remanded the cause to this Court. 767 S.W.2d 709 (Tex. 1989). Although the Supreme Court recognized

that the trial court had dismissed the case below, we were directed to ignore what it termed an "inconsistency" and instructed that we were obliged to render an opinion on whether the rules were valid despite the posture of the case. We question whether doing so complies with or violates Tex. R. App. P. Ann. 81(c) and 90(a) (Supp. 1989). Nevertheless, in reviewing the matter, we will sustain appellants' challenge to the rules and reverse the judgment of the trial court.

Appellants requested a ruling as to the validity of certain of the Commission's "ratable take" and "proration" rules governing the natural gas industry. *See* Tex. R.R. Comm'n Rules, 12 Tex. Reg. 536 (1988) (to be codified at 16 Tex. Admin. Code §§ 3.30(a)(1),(5) and 3.34 (h)(2-4) (since amended)). These rules were promulgated in response to the creation of special marketing programs (SMPs). SMPs are affiliates of larger companies that are able to buy gas in circumvention of established contracts and Commission policies that would be applicable to the larger companies.

Section 30(a)(1) defines a "first purchaser" as "the first purchaser of natural gas produced from a well," but adds "[a] first purchaser and any affiliate of the purchaser that transports any natural gas it purchases from a well by use of the same pipeline system used by the first purchaser of which it is an affiliate shall be treated as a single first purchaser for purposes of ratability requirements," unless the affiliate is a special marketing program under section 3.34(h).

Section 30(a)(5) defines an affiliate as a "person or entity that owns, is owned by, or is under common ownership with another person or entity to the extent of 50%

or more or that otherwise controls or is controlled by another person or entity," adding "affiliates of a common entity are also affiliates of each other," and listing certain exceptions.

Section 34(h) sets out the scheme for qualifying an affiliate as a separate first purchaser by designating the affiliate as a SMP. The section requires:

> (2) Each and every special marketing program offer to purchase gas must be made without discrimination within a field and without unjust or unreasonable discrimination between fields to all operators for all wells on the pipeline system of the affiliated first purchaser from which that affiliated first purchaser has been purchasing and accepting delivery of gas as a first purchaser. The offer must also be made for all first, second and third priority category gas on the affiliated first purchaser's pipeline system which it has been purchasing and accepting for delivery under an obligation to purchase and accept delivery from the tailgate of a plant processing gas to extract liquids, or from a gathering system that purchases from wells and is required by contract or by its physical connections to sell its gas entirely to the affiliated first purchaser, whether or not those purchases were made as a first purchaser.
>
> (3) It is unreasonably discriminatory, and therefore prohibited, for the offer to purchase gas in the special marketing program, or from any release of gas for sale in the special marketing program to require release of any claims under any existing contract other than a release of the gas for sale in the special marketing program or a requirement of a volume-for-volume basis for gas taken in the special marketing program to be credited against any existing contract, if the credit provision is limited to the period of actual participation in the special marketing pro-

gram. Nothing in this paragraph shall prohibit an operator of any well from offering terms inconsistent with these provisions. The making of an offer which is not accepted shall not affect rights under existing contracts.

(4) If the well producing priority category 1, 2 or 3 gas is shut in or curtailed, and waste is found by the Commission to exist, neither a special marketing program purchaser nor its affiliated first purchaser may purchase lower priority category gas until all the priority category 1, 2 and 3 gas is taken and resulting waste is prevented. The Commission shall expedite determination of waste, and may enter an emergency, temporary or interim order upon affidavit proof that waste is occurring.[1]

The trial court judgment states "the Commission did not exceed its lawful authority in enacting, adopting, and implementing the rules under attack herein."

Appellants complain that the district court erred in declaring the challenged rules valid because: (1) the rules are beyond the Commission's statutory authority; (2) the rules are inconsistent with the statutes; (3) the statutes provide no guidelines or standards governing the Commission's jurisdiction in this subject matter, resulting in an unconstitutional delegation of legislative power; (4) the rules are contrary to the public policy of Texas

1. The Commission amended Rule 34(h)(3) so that it prohibits an offer to a producer to participate in a special marketing program to "require modification of any existing contract provisions," except a volume-for-volume credit against the particular contract from which gas is released for sale to the SMP. 12 Tex. Reg. 4325 (Nov. 20, 1987); 134 Tex. Reg. 838 (Feb. 12, 1988). The Commission amended Rule 34(h)(4) so that a waste complaint must be accompanied by supporting documentation and a statement that all documents filed have been served on the first purchaser and any affiliated SMP. 12 Tex. Reg. 2860-2861 (Aug. 25, 1987).

and the United States and are preempted by federal statute; and (5) the rules deprive appellant of state and federal constitutional rights to due process and equal protection of the laws. We will dispose of the state law grounds before reaching appellants' federal constitutional claims. *See* Hagans v. Lavine, 415 U.S. 528, 547 (1974); Southern Nat'l Bk. of Houston v. City of Austin, 582 S.W.2d 229, 235 (Tex. Civ. App. 1979, writ ref'd n.r.e.).

Appellant Lone Star is both an intrastate and an interstate pipeline company. It seeks a declaration as to the applicability of the rules to its intrastate pipeline system. Appellant Enserch Gas Company (Enserch) is a gas marketing company that utilizes the Lone Star pipeline system to make deliveries to its customers. Both are wholly-owned by Enserch Corporation. Enserch Gas purcases gas from the spot market, i.e., gas that is not dedicated to long-term gas contracts and is available for immediate sale. The spot market price of gas is much lower than the long-term contract price. Enserch often purchases gas from operators who have long-term contracts with Lone Star. Just as often, however, it purchases from operators with whom Lone Star has had no relationship. Moreover, Enserch often has conditioned its purchases from these operators upon their crediting the Enserch purchase against the amount Lone Star is obligated to take from the operator. Lone Star and Enserch both sell gas to local gas utilities.

First, appellants complain that the challenged rules are beyond the Commission's statutory authority. The Commission has been granted broad discretion in administering the laws regarding natural gas regulation. Burford v. Sun Oil Co., 319 U.S. 315 (1943). We are obligated

to hold that the rules are valid if constitutional, within the power granted to the Commission, and promulgated pursuant to the proper procedure. Helle v. Hightower, 735 S.W.2d 650, 654 (Tex. App. 1987, writ denied). We presume the rules are valid, particularly where they have been adopted following notice and public hearing. Trapp v. Shell Oil Co., 198 S.W.2d 424 (Tex. 1946); *see also* Bullock v. Hewlett-Packard Co., 628 S.W.2d 754, 756 (Tex. 1982); Texas Liquor Control Bd. v. Attic Club, Inc., 457 S.W.2d 41, 43 (Tex. 1970).

The Commission's statutory authority is derived from legislative delegations of authority codified in the Texas Natural Resources Code. Texas Nat. Res. Code Ann. § 86.041 (1978) states:

> The Commission has broad discretion in administering the provisions of this chapter and may adopt any rule or order in the manner provided by law that it finds necessary to effectuate the provisions and purposes of this chapter.

For example, the Commission may proscribe practices it determines to be wasteful, even if those practices are not statutorily proscribed. *Shell Oil,* 206 S.W.2d at 241. Indeed, the Commission has an affirmative duty to prevent waste and conserve gas. Railroad Comm'n v. Rowan Oil Co., 259 S.W.2d 173, 176 (Tex. 1953). The Commission states in its preamble to the rules that they are adopted pursuant to the Commission's general rulemaking authority granted in section 81.052; section 85.202, relating to the conservation of oil and gas and prevention of waste of oil and gas; section 86.041, further authority for prevention of waste and conservation of gas; and sections 111.083, 111.090, and 111.133 (the Common Purchaser

Act), relating to purchases and takes by common purchasers without discrimination or the use of monopolistic practices.

The Commission promulgated the challenged rules to protect priority schemes concerning nominations, purchases, and the production of gas following the advent of SMPs. These schemes in turn assure that casinghead gas, oil, and special allowable wells continue producing. The rules enhance the Commission's ability to regulate waste, promote conservation, protect correlative rights, prevent discrimination, and encourage production by purchasers and their SMP affiliates. The rules are in harmony with the general objectives of the act involved. *See* Gerst v. Oak Cliff Savings and Loan Association, 432 S.W.2d 702, 706 (Tex. 1968); Jefco, Inc. v. Lewis, 520 S.W.2d 915, 921 (Tex. Civ. App. 1975, writ ref'd n.r.e.). The Commission may refuse to consider affiliates as separate first purchasers in order to promote its protective scheme.

Second, appellants complain that the challenged rules are inconsistent with the statutes cited by the Commission as authority to promulgate the rules. We hold that the questioned rules are consistent with statutes aimed at preventing waste, protecting correlative rights, and preventing discrimination. The Commission's long-established rules and policies were designed and implemented to achieve those goals, and the Commission has demonstrated that without the challenged rules the protective scheme to effectuate those goals will be circumvented. Appellants vigorously complain that the rules cannot be valid because there has been no evidentiary hearing in which the Commission found Lone Star to have encouraged waste or to have discriminated in purchasing gas.

It is well-settled that because the Commission is charged with supervising gas production, it has the "power to devise some reasonably definite plan or pattern to start with." Gulf Land Co. v. Atlantic Richfield Co., 131 S.W. 2d 73, 80 (Tex. 1939). Because the rules provide a procedure to obtain variances, the rules are not beyond the Commission's power to promulgate. *Gulf Land Co.*, 131 S.W.2d at 80. We note further that the Commission is specifically permitted to act by rule. *See* Tex. Nat. Res. Code Ann. §§ 81.052, 85.201, 85.202(b), 86.041, 86.042, 111.090, and 111.133 (Supp. 1989). The questioned rules are consistent with statutes relied upon by the Commission.

Third, appellants complain that the statutes upon which the Commission relies for rulemaking authority in this instance contain no standards for the exercise of such authority. Specifically, appellants complain that the statutes do not define "affiliate," indicate that affiliated first purchasers may be treated as single first purchasers, or "define the concept of discrimination as encompassing the content of contractual negotiations."

The delegation doctrine requires that the statute relied upon by a regulatory agency set forth the policy of the state as adopted by the legislature and establish the primary standards to which the government and the public must adhere. Southwestern Savings & Loan Assoc. v. Faulkner, 331 S.W.2d 917, 921 (Tex. 1960). This standard may be broad where conditions that cannot be conveniently investigated by the legislature must be considered. Corzelius v. Harrell, 186 S.W.2d 961, 964 (Tex. 1945); Housing Authority of the City of Dallas v. Higgingbotham, 143 S.W.2d 79, 87 (Tex. 1940). The agency

may adopt rules within the parameters of the general policy defined by the legislature. Brown v. Humble Oil & Refining Co., 83 S.W.2d 935, 940 (Tex. 1935).

The legislature's failure to address specific unforeseen circumstances in the statutes that delegate authority to the Commission does not render the statutes invalid for "want of standards." To require that legislation address each possible exercise of agency power would defeat the purpose of delegating legislative authority. *See Corzelius*, 186 S.W.2d at 964. The standards here are found in the statutes directing the Commission to prevent waste, promote conservation, and protect correlative rights. The Commission has exercised its constitutionally delegated authority in implementing the challenged rules.

Fourth, appellants complain that the challenged rules contravene state and federal public policies and are preempted by federal law. Appellants reason that any regulatory action having the direct or indirect effect of increasing the prices appellants pay for gas is against public policy. While regulations causing unreasonably high price increases have been successfully challenged, price is only one factor to be considered in evaluating whether a statute promotes public policy. Appellants offered no evidence that the challenged rules cause such unreasonably high price increases that the rules contravene public policy, and the Commission offered evidence that other public policy interests would be promoted by implementation of the challenged rules.

Appellants argue that the rules in question have been preempted by both the Natural Gas Act, 15 U.S.C.A. §§ 717-717z (West 1976 & Supp. 1989), and the Natural Gas Policy Act of 1978, 15 U.S.C.A. §§ 3301-3432

(West 1982 & Supp. 1989)[2]. It is clear that a finding of preemption is not favored, and it should not be made in the absence of persuasive reasons. Chicago & North Western Transp. v. Kalo Brick & Title Co., 450 U.S. 311, 317 (1981). Moreover, a presumption exists against finding preemption of state law in areas traditionally subject to state regulation. California v. ARC America Corp., 490 U.S. ____, ____ (1989). Nevertheless, we must reach such a conclusion in this instance.

Before the NGPA's passage, interstate natural gas transportation and sales were subject to the NGA. The NGA established an intricate price control system to regulate the transport and sale of gas in interstate commerce. "Interstate commerce" is defined in the NGA as "commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commerce takes place within the United States." 15 U.S.C.A. § 717a(7). It thus established a comprehensive scheme to govern all interstate gas transactions. Northern Natural Gas Co. v. State Corp. Comm'n of Kansas, 372 U.S. 84, 91 (1963). The NGA did not apply to "the production or gathering of natural gas." 15 U.S.C.A. § 717(b). That function was reserved for the states. Interstate Natural Gas Co. v. Federal Power Comm'n, 331 U.S. 682, 690 (1947).

The United States Supreme Court has held that under the NGA, state regulation of purchasers is completely pre-

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2. Appellant's third point of error is divided into five subparts. Subpart (E), with which we are concerned, argues that the challenged rules are against the public policy of Texas, the public policy of the United States, and are preempted by federal law. The point is multifarious. Tex. R. App. P. Ann. 74(d) (Supp. 1989). Nevertheless, we are directed to determine whether the rules are valid. We will consider the point of error.

empted and, therefore, any such regulation is void. *Northern Natural,* 372 U.S. at 92. In *Northern Natural,* the Kansas Corporation Commission had promulgated regulations requiring interstate pipeline companies to purchase gas ratably from all wells connected to their pipeline system in each field within the state. The regulation implemented a Kansas statute that empowered the Commission to regulate gas production so as to prevent discrimination against gas producers and encourage gas conservation. The Supreme Court held that because the regulations were directed at gas purchasers subject to federal regulation, the fact that the regulations were intended to promote natural gas conservation was immaterial. *Northern Natural,* 372 U.S. at 92. The Court held that both direct price regulation and regulations affecting interstate gas prices were preempted and therefore void. *Northern Natural,* 372 U.S. at 91.

After the energy shortages of the 1970s, Congress perceived the need to permit market forces to affect natural gas prices. To this end, it passed the Natural Gas Policy Act of 1978. Transcontinental Pipe Line Corp. v. State Oil and Gas Board of Mississippi, 474 U.S. 409, 420 (1986). The NGPA substantially reduced the level of federal gas regulation. However, rather than reflecting a wholesale retreat from the gas regulation field, the NGPA expands federal control in many respects because it delegates regulatory authority over intrastate transactions to the Federal Energy Regulatory Commission. *Transco,* 474 U.S. at 421. It also preserves the NGA pricing structure over "old" gas.[3] 15 U.S.C.A. § 3431. FERC is given the power to set the rates and prices by which most intra-

3. "Old gas," for the purpose of discerning whether the NGA is applicable, is that gas which was committed or dedicated to interstate commerce as of November 8, 1978. 15 U.S.C.A. § 3431(a)(1)(A).

state transactions take place. 15 U.S.C.A. § 3371(a)(2) and (b)(2). This section is implemented by FERC at 18 C.F.R. §§ 284.1 - 284.305 (1989).

The Supreme Court has consistently held that under the NGPA, state attempts to regulate gas prices by regulating natural gas purchasers are preempted by federal law. Northwest Central Pipeline Corp. v. State Corp. Comm'n of Kansas, 489 U.S. ____, ____ (1989); Schneidewind v. ANR Pipeline Co., 485 U.S. ____, ____ (1988); *Transco*, 474 U.S. at 423. States may continue to regulate production in a manner that incidentally affects purchasers' costs. *Northwest Pipeline*, 489 U.S. at ____; *Schneidewind*, 485 U.S. at ____. However, the NGPA preempts such production regulations if the regulations have an impact on matters within federal control and are not an incident of efforts to achieve a "proper state purpose." *Northwest Pipeline*, 489 U.S. at ____.

The *Transco* Court applied three factors to decide whether the challenged state natural gas regulations were preempted. These are (1) whether the regulation comes within the limits of the comprehensive federal regulatory scheme; (2) whether the state regulation conflicts with the federal interest, expressed by both Acts, in protecting gas consumers by ensuring low gas prices; and (3) whether the regulation is directed at purchasers. *Transco*, 474 U.S. at 420, 423. Thus, in *Transco*, Mississippi's regulation requiring gas purchasers to take gas ratably and without discrimination from all producers in a gas pool was held to be preempted. In *Schneidewind*, the Court held that Michigan's attempt to require an interstate pipeline to obtain approval of its Public Service Commission before issuing long-term securities was preempted because the clear object of the statute was to regulate gas rates.

Schneidewind, 485 U.S. at ____. In *Northwest Pipeline*, however, the challenged Kansas regulation that cancelled producers' production allowables where the actual production was far below the allowable was upheld on the grounds that Kansas was regulating producers and that the regulation had negligible price effects. *Northwest Pipeline*, 489 U.S. at ____.

Appellees argue that the regulations are designed to prevent waste, promote conservation, and protect correlative rights. These are proper state purposes. Where a state regulates producers to attain these goals, the incidental effect on purchasing decisions does not generally result in a finding of preemption. *Northwest Pipeline*, 489 U.S. at ____. However, as noted above, federally-regulated purchasers may not be made the subject of state regulation. Lone Star and Enserch are federally-regulated purchasers because each is an intrastate pipeline that sells to both interstate pipelines and to local distribution companies served by interstate pipelines. 15 U.S.C.A. § 3371(b)(2)(A)(i) and (ii).

Appellees further argue that because production and sales are part of an "integrated system," the state validly may take measures to affect a pipeline's capacity in order to prevent waste by producers. Thus, claim appellees, although the challenged rules strictly regulate how SMPs and their affiliates purchase surplus gas, the rules affect production and are therefore within the sphere of permissible state regulation. *See* 12 Tex. Reg. 536-37. This argument fails for several reasons. First, it concedes that purchasers are regulated. Second, even though the challenged regulations may regulate producers, the regulations also create higher gas prices in the spot markets in which

SMPs operate.[4] They therefore constitute an improper state purpose under *Northwest Pipeline* and come within

4. In determining that the Railroad Commission intended to maintain increased spot market prices, we have looked to several sources. First, trial testimony establishes the fact. Former Commissioner Clark Jobe testified that the regulations were adopted to address the problem of too much market leverage being exercised by purchasers. Moreover, we have looked to the statement accompanying the rule. *See* Beal, *The Scope of Judicial Review of Agency Rulemaking: The Interrelationship of Legislating and Rulemaking in Texas*, 29 Baylor L. Rev. 597, 677 (1987). The agency has stated, "[t]he sections are not intended to affect or influence the price of gas." They also state, however, "[i]t is the intent of the Commission that any offers resulting in curtailment or shutting in of gas . . . may be reviewed by the Commission to determine if the offers have resulted in waste." It also states, "[t]hat the section requires ratable production and purchases to be based on actual market demand." But the regulations make a quantity of gas demanded by a segment of purchasers unpurchasable. "Actual market demand" as stated here necessarily means the state-altered demand, which is another way of stating that purchases are to occur in a Texas-determined market structure. Finally, we have looked to other agency rules bearing on the same subject. *Beal, supra* at 677. We note that Commission Rules 30, 34, 64, 65, and 68 are the only Railroad Commission rules that regulate purchasers to any significant degree. Other than Rules 30 and 34, these rules plainly affect producers only to the extent necessary to control waste and encourage conservation. Other commission rules control the gas production side of the Texas natural gas market, *e.g.*, Rule 31 (gas well allowables) and Rules 101-104 (NGPA operator permit process). Rule 30, however, puts extensive burdens on first purchasers. They must nominate the quantity of gas to be taken from each operator, in order to permit the Commission to "determine demand and set allowables for ratable production not exceeding market demand." Rule 30(d). Moreover, first purchasers are obligated to nominate no more than "anticipated market demand for gas on the pipeline system of the initial nominator for the month for which the nomination is made." Rule 30(e). Purchasers must also strictly nominate for the purchases of the majority of their downstream purchasers. Rule 30(f) obligates purchasers to buy on terms that "ratably apportion without unjust or unreasonable discrimination" as between fields where they purchase gas. This type rule was held by the Supreme Court to be preempted. *Transco*, 474 U.S. 409. Through this rule, as well as Rule 34, we find the pricing component of the Commission's attempt to regulate the entire intrastate gas market (and to some extent the interstate

its second criterion. Third, they regulate matters within the federal purchasing regulatory scheme. Appellee's argument that the regulations are production-oriented only is therefore belied. The regulations fly squarely in the face of the criteria utilized by the Supreme Court in *Northwest Pipeline*.

Appellees argue that the challenged regulations do not restrict the amount of gas available to qualified separate first purchasers. As a result, they conclude, the regulations do not distort the market by restricting supply and, thus, increasing price. First, Rule 34(h)(2) requires that SMPs purchase gas without discrimination within or between fields where the operators are on the affiliate's pipeline system. The rule obligates SMPs to buy only from producers on its affiliated pipeline system. Second, under Rule 34(h)(4), SMPs may not purchase lower priority gas from category 1, 2, or 3 gas producers whom the Commission has found to have created waste unless and until the SMP's affiliate has taken all of the field's higher priority gas. Third, under Rule 34(h)(3), SMPs are not permitted to negotiate with producers for a volume-for-volume credit against its affiliate's take-or-pay obligations, although producers are permitted to offer such credit on their own. If the affiliate SMP entities are not able to qualify under Rule 34, they are subject to the Rule 30 first purchaser requirements. These restrictions constitute a prohibition against a significant amount of otherwise permissible natural gas purchases. We reject the contention that the regulations do not restrict the quantity of available gas supplied.

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gas market, *see* Rule 30(e)). Given the agency's statements, Commissioner Jobe's testimony, and the context of these rules in other supply-restricting rules, we see that its price necessarily will be high by restricting the quantity as gas supplied.

The challenged rules come within the limits of the comprehensive NGPA scheme, they conflict with the federal interest in low gas prices, and they seek to regulate purchasers covered by the NGPA. As a result, Rules 30(a)(1) and (5), and 34(h)(2), (3), and (4) are preempted by federal law. By virtue of clause 2, Article VI of the United States Constitution, we hold the rules are therefore invalid.[5] Appellant's third point of error is sustained to the extent that it complains the rules are preempted by federal law.

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5. Although the parties have failed to bring two cases to our attention, we wish to distinguish our decision from those reached by the First Court of Appeals in Gulftide Gas Corp. v. Cox, 699 S.W.2d 239 (Tex. App. 1985, writ ref'd n.r.e.) and this Court in Bullock v. Enserch Exploration, Inc., 614 S.W.2d 215 (Tex. Civ. App. 1981, writ ref'd n.r.e.), cert. denied, 455 U.S. 946 (1982). In *Gulftide*, a gas transmission company sued a gas producer for breach of contract, fraud, and breach of fiduciary duty in their gas purchase contract. The First Court of Appeals held that the federal regulatory scheme did not preempt the authority of state courts to determine the validity of gas purchase contracts. This holding does not conflict with our decision today. In *Gulftide*, the court relied upon federal authority for the proposition that state courts may determine the validity of contract escalations under state law. *See* Pennzoil Co. v. Federal Energy Regulatory Comm'n, 645 F.2d 360 (5th Cir. 1981). We do not doubt that a state court may determine if a gas purchase contract is a valid contract under principles of state law. Whether the negotiated transaction is void under state regulations is a different issue.

Also, in *Enserch Exploration, Inc.*, this Court held that a federally-regulated interstate gas pipeline is subject to state franchise taxes for that proportion of gas it sells for resale out of state. There, we stated, "[i]n setting up these regulations Congress clearly intended that the price of natural gas would reflect the reasonable costs of its production and transportation." 614 S.W.2d at 219. We held that one such cost was to pay for state services supplied to the industry. Thus, the tax was permissible. Here, however, purchasers are required to shoulder a burden that the unrestricted market would not impose, namely, the burden of foregoing a significant percentage of potential gas purchases. An unrestricted market would have created a cost burden for the services supplied to the industry that we considered in *Enserch*. To that extent, the tax in *Enserch* is not akin to the regulations we consider today.

Because of our disposition, it is unnecessary to address appellant's remaining arguments. The judgment of the trial court is reversed and judgment is rendered that the challenged rules are declared invalid.

Marilyn Aboussie, Justice

[Before Chief Justice Shannon, Justices Gammage and Aboussie]

Reversed and Rendered

Filed: December 13, 1989

[Publish]

SUPREME COURT OF THE UNITED STATES
OFFICE OF THE CLERK
WASHINGTON, D. C. 20543

December 20, 1989

Mr. Jesse P. Luton, Jr.
700 Louisiana Street
4300 NCNB Center
Houston, TX 77002

Re: Lively Exploration Company, et al.,
v. Valero Transmission Company
No. 89-935

Dear Mr. Luton:

The petition for a writ of certiorari in the above entitled case was docketed in this Court on December 7, 1989 as No. 89-935.

Forms are enclosed for notifying opposing counsel that the case was docketed. Also enclosed is a form for the entry of your appearance as counsel.

This case has been filed as a petition for writ of certiorari. This Court no longer has jurisdiction over appeals from state courts or U.S. Courts of Appeals whose judgments were rendered after 9/25/88. See P. L. 100-352.

Very truly yours,

Joseph F. Spaniol, Jr., Clerk

By: /s/ STEFANI F. McDIVITT
Stefani F. McDivitt
Assistant

Enclosures

SUPREME COURT OF THE UNITED STATES
OFFICE OF THE CLERK
WASHINGTON, D. C. 20543

January 8, 1990

Mr. Jesse P. Luton, Jr., Esq.
700 Louisiana Street
4300 NCNB Center
Houston, Texas 77002

RE: LIVELY EXPLORATION COMPANY, et al. v.
VALERO TRANSMISSION COMPANY
No. 89-935

Dear Mr. Luton:

Thank you for informing me that I had incorrectly docketed your jurisdictional statement as a petition for writ of certiorari. I had overlooked the fact that the underlying judgment was issued before September 25, 1988.

This is to confirm that your jurisdictional statement is now docketed as an appeal, and that our records have been changed accordingly.

I apologize for the concern and confusion which my error has caused, and I appreciate your phone call.

Very truly yours,

JOSEPH F. SPANIOL, JR.,
CLERK

By

Stefani F. McDivitt
Assistant Clerk

cc: J. Clifford Gunter
Clerk, Court of Appeals of Texas
Fourth District (No. 04-87-00380-CV)